

# PUNCTURING THE RICO BALLOON: THE JUDICIAL IMPOSITION OF THE 10b-5 PURCHASER-SELLER REQUIREMENT

## INTRODUCTION

Congress passed the Racketeer Influenced and Corrupt Organizations Act<sup>1</sup> (RICO) in 1970 to enhance law enforcement capabilities in combating organized criminal activity.<sup>2</sup> Recently,<sup>3</sup> however, civil liti-

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1. Racketeer Influenced and Corrupt Organizations Act, Pub. L. No. 91-452, 84 Stat. 922 (1970) [hereinafter RICO] (codified at 18 U.S.C. §§ 1961-1968 (1988)).

2. RICO, *supra* note 1, 84 Stat. at 923 (“[T]he purpose of this act [is] to seek the eradication of organized crime . . . by strengthening the legal tools in the evidence-gathering process, by establishing new penal prohibitions, and by providing enhanced sanctions and new remedies to deal with the unlawful activities of those engaged in organized crime”). See Michael N. Glanz, Note, *RICO and Securities Fraud: A Workable Limitation*, 83 COLUM. L. REV. 1513 n.2 (1983) (stating that RICO’s purpose is to give law enforcement authorities more capable tools to battle organized crime). See also *In re Catanella*, 583 F. Supp. 1388, 1422 (E.D. Pa. 1984) (stating that the purpose of RICO is “to quell the potency and persistence of organized crime”).

Congress designed RICO to fight organized criminal conduct, not simply organized crime. RICO does not per se legalize membership in the mafia. Congress justifiably feared that legalizing mafia membership would be unconstitutional. See, e.g., 116 CONG. REC. 35,343 (1970), cited with approval in Glanz, *supra*, at 1527 n.105 (declaring that Congress rejected Senator Biaggi’s proffered RICO amendment which would have per se legalized mafia membership); Andrew P. Bridges, *Private RICO Litigation Based upon “Fraud in the Sale of Securities”*, 18 GA. L. REV. 43, 49 (1983) (stating that the constitutional right to freedom of association created an obstacle to the passage of a per se illegal organized crime membership law).

Congress also feared that organized crime elements would create ways to avoid a specific “organized crime” provision and that prosecutors would have difficulty proving mob membership. *Hanna Mining Co. v. Noreen Energy Resources Ltd.*, [1982 Decisions] Fed. Sec. L. Rep. (CCH) ¶ 98,742 at 93,736 (N.D. Ohio, June 11, 1982). As a result of these concerns, Congress enacted a RICO statute which “make[s] . . . violations dependent upon behavior, not status.” *United States v. Forsythe*, 560 F.2d 1127, 1136 (3d Cir. 1977). Congress included offenses “characteristic of organized crime,”

gants<sup>4</sup> have utilized RICO outside the context of organized crime to bring securities fraud claims.<sup>5</sup> In the mid-1980's, for example, civil

not offenses committed "primarily by members of organized crime," as the predicate offenses which form the substance of RICO. *In re Catanella*, 583 F. Supp. at 1429. (quoting 116 CONG. REC. 18,940 (1970)).

Therefore, Congress was aware that plaintiffs would bring RICO claims against non-mafioso defendants. 583 F. Supp. at 1429. During congressional debate, the following colloquy occurred between the Chairman of the Judiciary Committee, Congressman Celler, and the Attorney General of the United States, Mitchell:

CHAIRMAN: . . . Is . . . [RICO] limited to so-called "organized crime" offenders . . . ?

ATTORNEY GENERAL MITCHELL: It is not so limited, Mr. Chairman. . . .

CHAIRMAN: Of Course, [RICO] is called the "organized crime" bill . . . [M]aybe we should call [RICO] something else. I think it gives a misapprehension.

*Organized Crime Control: Hearings on S. 30 and Related Proposals before Subcomm. No. 5 of the House Comm. on the Judiciary*, 91st Cong., 2d Sess. 185 (1970) [hereinafter *House Hearings*]. See also G. Robert Blakey, *The RICO Civil Fraud Action in Context: Reflections on Bennett v. Berg*, 58 NOTRE DAME L. REV. 237, 273 n.112 (1982).

Indeed, "[i]t is impossible to draw an effective statute which reaches most of the commercial activities of organized crime, yet does not include offenses commonly committed by persons outside organized crime as well." John L. McClellan, *The Organized Crime Act (S. 30) Or Its Critics: Which Threatens Civil Liberties?*, 46 NOTRE DAME LAW. 55, 143 (1970) (the author of this article, who was a co-sponsor of RICO, responding to critics of the statute's broad reach).

In sum, Congress did not enact RICO specifically to fight organized crime, but rather to fight organized criminal conduct by "any person." 18 U.S.C. § 1962 (1988).

3. Civil plaintiffs did not begin using RICO until the mid-1980s. See Jeffrey G. MacIntosh, *Racketeer Influenced and Corrupt Organizations Act: Powerful New Tool of the Defrauded Securities Plaintiff*, 31 KAN. L. REV. 7, 11 (1982) (noting that few RICO securities fraud cases existed before 1982); Glanz, *supra* note 2, at 1517 (same); Louis C. Long, *Treble Damages for Violations of Federal Securities Laws: A Suggested Analysis and Application of the RICO Civil Cause of Action*, 85 DICK. L. REV. 201, 209-10 (1981) (suggesting that plaintiff's lawyers lacked confidence in RICO because of early setbacks in RICO claims).

4. RICO's substantive provision, § 1962, is a criminal provision and § 1963(a) provides an express criminal cause of action. Congress added a civil enabling provision, § 1964, in order to increase deterrence and facilitate criminal enforcement of the statute. Bridges, *supra* note 2, at 44. Congress gave private litigants a civil remedy to encourage them to serve as private prosecutors. *Id.* at 44 n.10 (citing *Hawaii v. Standard Oil Co.*, 405 U.S. 251, 262 (1972)). See *infra* notes 161-69 for a discussion of the importance of the role of private litigants in enforcing RICO.

5. See, e.g., *Ashland Oil, Inc. v. Arnett*, 875 F.2d 1271 (7th Cir. 1989) (bankruptcy fraud); *Northeast Women's Center, Inc. v. McMonagle*, 868 F.2d 1342 (3d Cir. 1989) (pro-life demonstrators), *cert. denied*, 493 U.S. 901 (1989); *Saporito v. Combustion Engineering Inc.*, 843 F.2d 666 (3d Cir. 1988) (employee benefit suits); *Yellow Bus Lines, Inc. v. Drivers, Chauffeurs & Helpers Local Union 639*, 839 F.2d 782 (D.C. Cir. 1988) (labor-management disputes); *Cowan v. Corley*, 814 F.2d 223 (5th Cir. 1987) (against local governments); *Bennett v. Berg*, 710 F.2d 1361 (8th Cir. 1983) (retirement home

securities fraud litigation involving RICO claims dramatically increased.<sup>6</sup> The increase of this use of RICO in securities litigation has caused great concern throughout the legal<sup>7</sup> and business communities.<sup>8</sup> Courts have generally responded to this concern by narrowly interpreting RICO's securities fraud provision to limit civil cases brought under RICO.<sup>9</sup>

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rip-off); *Williams v. Hall*, 683 F. Supp. 639 (E.D. Ky. 1988) (wrongful discharge); *FMC Corp. v. Boesky*, 673 F. Supp. 242 (N.D. Ill. 1988) (takeover battles); *Nelson v. Bennett*, 662 F. Supp. 1324 (E.D. Cal. 1987) (against accounting firms); *Hunt v. Weatherbee*, 626 F. Supp. 1097 (D. Mass. 1986) (sexual harassment). See generally Thomas F. Harrison, *Look Who's Using RICO*, 75 A.B.A. J. 56 (Feb., 1989) for a survey of various causes of action under RICO.

See also *Sedima v. Imrex Co.*, 473 U.S. 479, 499 (1985) (stating that "[t]he fact that [civil RICO] is used against respected businesses allegedly engaged in a pattern of specifically identified criminal conduct is hardly a sufficient reason for assuming that the provision is being misconstrued"); *Haroco, Inc. v. American National Bank & Trust Co.*, 747 F.2d 384, 398 (7th Cir. 1984) ("[T]he fact that RICO has been applied in situations not expressly anticipated by Congress does not demonstrate ambiguity. It demonstrates breadth.").

6. See *supra* note 5 for a discussion of the onset of securities fraud litigation in the 1980's under RICO.

7. The American Bar Association has been a vocal critic of RICO. See, e.g., Nancy Blodgett, *Revamping RICO: Congress gets into the act*, 71 A.B.A. J. 32 (Dec., 1985) (stating that the ABA Criminal Justice Section supports RICO amendment legislation); Paul Marcotte and Nancy Blodgett, *RICO, Rights Top ABA Agenda: Delegates urge federal racketeering law cutback*, 72 A.B.A. J. 28 (Oct. 1, 1986) (noting that an ABA House of Delegates passed a resolution supporting an amendment that would limit the scope of RICO); Rhonda McMillion, *Push for RICO Reform Continues*, 76 A.B.A. J. 109 (April, 1990) (noting that the ABA President and ABA Special RICO Coordinating Committee chairman urge Congress to limit the reach of RICO); Rhonda A. McMillion, *ABA Urges RICO Reform*, 74 A.B.A. J. 147 (Oct. 1, 1988) (stating that the ABA endorsed the efforts of several Congressmen to reform RICO); Debra C. Moss, *Plaintiffs Going For Broke(r): Investor suits against stockbrokers on the increase*, 73 A.B.A. J. 18 (May 1, 1987) (noting that suits by investors against stock brokers are on the rise partially because of the increased use of RICO).

Even in the Supreme Court, RICO has detractors. See *Sedima*, 473 U.S. at 501 (Marshall, J. dissenting) (finding that Congress did not intend for plaintiffs to use RICO in ordinary commercial litigation); Paul Marcotte, *Rehnquist: Cut Jurisdiction, Chief Justice Outlines Reform Proposals in ABA Speech*, 75 A.B.A. J. 22 (April, 1989) (noting that Chief Justice Rehnquist recommended that Congress limit the availability of private civil RICO actions).

8. Bridges, *supra* note 2, at 47 (stating that "[r]ecent litigation under RICO has produced strong reaction from the commercial sector and businessmen . . . are now beginning to take [RICO] seriously") (footnote omitted).

9. Courts have utilized numerous methods in limiting RICO's applicability. Some of these methods include: (1) requiring plaintiffs to show an affiliation with organized crime; (2) requiring the plaintiff's injury to result from the illegal competitive advantages arising from the defendant's racketeering; or (3) requiring plaintiffs to prove an

In 1990, however, the Ninth Circuit Court of Appeals declined to follow this narrow interpretation of the RICO securities fraud provision. The court in *Securities Investor Protection Corp. v. Vigman*<sup>10</sup> refused to limit standing to sue<sup>11</sup> under the RICO securities fraud provision to purchasers or sellers of securities,<sup>12</sup> as required by Section 10(b) of the 1934 Securities Exchange Act<sup>13</sup> and its companion Rule 10b-5<sup>14</sup> (hereinafter collectively referred to as 10b-5).

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injury "by reason of" a RICO violation. Glanz, *supra* note 2, at 1526-33 (stating that "the very breadth and vagueness of the RICO statute suggest that the courts assume some control . . . in civil actions"). See *Spencer Cos., Inc. v. Agency Rent-A-Car*, [1981-82 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,361, at 92,217 (D. Mass. Nov. 17, 1981). Glanz, *supra* note 2, at 1526-1533.

The Supreme Court, however, has repudiated lower court efforts to impose limiting standards on RICO.

It is true that private civil actions under . . . [RICO] are being brought almost solely against [commercial] defendants, rather than against the archetypal, intimidating mobster. Yet this defect — if defect it is — is inherent in the statute as written, and its correction must lie with Congress. It is not for the judiciary to eliminate the private action in situations where Congress has provided it. . . .

*Sedima v. Imrex*, 473 U.S. 479, 499-500 (1985) (footnote omitted).

10. 908 F.2d 1461 (9th Cir. 1990), *cert. granted in part sub nom. Holmes v. SIPC*, 113 L.Ed.2d 716 (1991).

11. Commentators and courts use the phrases "standing to sue" and "state a cause of action" interchangeably when discussing whether the RICO securities fraud predicate offense contains a 10b-5 purchaser-seller limitation. See Glanz, *supra* note 2, at 1518 n.34 (noting that although the Supreme Court has used the terms "standing" and "cause of action" interchangeably at times, the Court has also suggested that the two should be distinguished). In this Note, the term "standing" generally refers to whether a given plaintiff can maintain a civil RICO action.

12. 908 F.2d at 1465-67.

13. Securities Exchange Act of 1934, ch. 404, § 10(b), 48 Stat. 891 (1934) (codified at 15 U.S.C. § 78j(b) (1988)). Section 10(b) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

*Id.*

14. 17 C.F.R. § 240.10B-5 (1991). The text of Rule 10b-5 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the

This Note argues that courts should not limit RICO securities fraud claims by imposing the 10b-5 purchaser-seller standing requirement. Part I of this Note discusses the background, text, and legislative history of RICO. Part II discusses 10b-5 and its standing requirement. Part III discusses the case law on RICO securities fraud. Finally, Part IV analyzes the case law and argues that the Ninth Circuit correctly ruled that the 10b-5 purchaser-seller requirement does not limit standing to bring a RICO securities fraud claim.

## I. THE RICO SECURITIES FRAUD PREDICATE ACTION

### A. *General Background of RICO*

Despite numerous criticism and objections,<sup>15</sup> Congress phrased the RICO provisions broadly.<sup>16</sup> Moreover, Congress reinforced the broad language by placing a liberal construction provision directly in the statute for courts to follow.<sup>17</sup> The Supreme Court recognizes the liberal construction clause and interprets civil RICO broadly in compliance with Congress' mandate.<sup>18</sup>

In addition, Congress created many new procedural advantages for

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circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

*Id.*

The Securities Exchange Commission (SEC) promulgated Rule 10b-5 pursuant to its authority under § 10(b). *See supra* note 13 for the text of § 10(b).

15. *See infra* note 46 and accompanying text for a discussion of the legislative history of RICO and criticism of RICO during congressional debate on the bill.

16. *In re Catanella*, 583 F. Supp. 1388, 1423 (E.D. Pa. 1984) (finding that "[t]rue to its word, Congress formulated a broad statute"). *See also Haroco, Inc. v. American Nat'l Bank and Trust Co. of Chicago*, 747 F.2d 384, 390 (7th Cir. 1984) (stating that "Congress deliberately chose the very broad language of RICO's provisions . . . [such that] the proponents and opponents of RICO recognized the extraordinary breadth of its terms"); Arthur F. Mathews, *Shifting the Burden of Losses in the Securities Markets: The Role of Civil RICO in Securities Litigation*, 65 NOTRE DAME L. REV. 896, 926 (1990) (RICO has "unduly broad and facially clear language") [hereinafter Mathews, *RICO in Securities Litigation*]. *See supra* note 2 for a discussion of the purposes of RICO and the reasons behind its broad construction.

17. Racketeer Influenced and Corrupt Organizations Act, Pub. L. No. 9-452, § 904(a), 84 Stat. 922, 947 (1970) provides: "[t]he provisions of this title shall be liberally construed to effectuate its remedial purposes."

18. *See, e.g., Sedima v. Imrex Co.*, 473 U.S. 479, 492 n.10 (stating that "if Congress' liberal construction mandate is to be applied anywhere, it is in § 1964, where RICO's remedial purposes are most evident").

criminal prosecutors under RICO.<sup>19</sup> Civil RICO litigants also received extensive procedural advantages including treble damages,<sup>20</sup> attorney's fees,<sup>21</sup> liberal discovery, permissive venue,<sup>22</sup> nationwide service of process<sup>23</sup> and expedited trial dates.<sup>24</sup> Congress' broad drafting and expansive provisions produced a "powerful tool"<sup>25</sup> which both civil litigants and criminal prosecutors could use to attack alleged RICO violators.

### B. *The Statutory Language*

Securities fraud plaintiffs can bring civil RICO claims under § 1964(c).<sup>26</sup> Under § 1964(c), any person injured "by reason of" a violation of criminal RICO, § 1962,<sup>27</sup> has standing to bring a civil claim under RICO.<sup>28</sup> To incur criminal liability under RICO, § 1962(c)<sup>29</sup> requires a "pattern"<sup>30</sup> of "racketeering activity"<sup>31</sup> by a defendant in-

19. See, e.g., 18 U.S.C. § 1963(a)(1) (1988) (allowing prosecutors to seize illegal profits from RICO violators); 18 U.S.C. § 1968 (1988) (allowing the Attorney General to demand evidence from defendants).

20. 18 U.S.C. § 1964(c) (1988). See *infra* notes 161-69 and accompanying text for a discussion of the importance of civil litigants to RICO's enforcement.

21. *Id.*

22. *Id.* § 1965.

23. *Id.* § 1965(c) and (d).

24. *Id.* § 1966.

25. MacIntosh, *supra* note 3, at 7 (concluding that RICO is a "powerful new tool" for defrauded securities plaintiffs).

26. 18 U.S.C. § 1964(c) (1988) reads in pertinent part:

Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee.

*Id.*

27. 18 U.S.C. § 1962(a)-(d) (1988) proscribes four general activities.

28. See *supra* note 26 for the statutory language of 18 U.S.C. § 1964(c) (1988). Civil RICO claimants rely upon the same substantive provision as criminal prosecutors. Thus, "RICO provides the only *civil* action where the defendant pleads 'not guilty.'" Bridges, *supra* note 2, at 44. See *supra* note 4 and accompanying text for a discussion of the reasons behind this dichotomy.

29. 18 U.S.C. 1962(c) (1988) mandates:

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.

*Id.*

30. 18 U.S.C. § 1961(5) (1988) defines a "pattern of racketeering activity" as: "at

volved in an "enterprise."<sup>32</sup> Section 1961(1)(A)-(D) defines "racketeering activity" as a violation of any of the listed federal or state crimes, labeled predicate offenses.<sup>33</sup> One predicate offense listed in § 1961 is "[f]raud in the sale of securities."<sup>34</sup>

Under the statute's plain language, "any person injured"<sup>35</sup> by reason of "fraud in the sale of securities"<sup>36</sup> "may sue"<sup>37</sup> under RICO.<sup>38</sup> Unlike most other listed predicate offenses, RICO's securities fraud provision does not refer to a specific statute. For example, most of the listed predicate offenses in § 1961 refer to other federal statutes containing the predicate offense's standing requirements and prima facie elements.<sup>39</sup> However, Congress failed to list any statutory references enumerating the standing requirements for the RICO securities fraud offense.<sup>40</sup> Thus, courts look to the legislative history of the securities

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least two acts of racketeering activity, 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." *Id.*

31. 18 U.S.C. § 1961(1) (1988) divides "racketeering activity" into five major categories: (A) specific state law crimes, (B) specific federal crimes, (C) federal labor crimes, (D) miscellaneous crimes, including drug offenses and "fraud in the sale of securities," and (E) "any act which is indictable under the Currency and Foreign Transaction Reporting Act."

32. Under 18 U.S.C. § 1961(4) (1988), an "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."

33. Bridges, *supra* note 2, at 45 n.11. The offenses are labeled "predicate" in that they constitute the necessary foundation for a RICO violation. *Id.*

34. 18 U.S.C. § 1961(1)(D) (1988).

35. *Id.* § 1964(c).

36. *Id.* § 1961(1)(D).

37. *Id.* § 1964(c).

38. In evaluating a statute, courts must first look "to its language." *United States v. Turkette*, 452 U.S. 576, 580 (1981) (holding that an "enterprise" under RICO encompasses both legitimate and illegitimate enterprises).

39. Most predicate offenses in 18 U.S.C. § 1961(1) contain statutory references, i.e., 18 U.S.C. § 1341 (relating to mail fraud) and 18 U.S.C. § 1343 (relating to wire fraud). Courts utilize these statutory references to determine standing and the prima facie elements of the RICO predicate offense. *See* Bridges, *supra* note 2, at 59 (stating that "fraud in the sale of securities" lacks the specific references to offenses that the other predicate crimes provide).

40. Mathews, *RICO in Securities Litigation*, *supra* note 16, at 944 (stating that the securities fraud predicate offense contains no reference to any title of the United States Code or federal securities statutes).

fraud offense in order to define its standing requirements.<sup>41</sup>

### C. *The Legislative History*<sup>42</sup>

RICO's legislative history offers little guidance interpreting the securities fraud predicate offense.<sup>43</sup> The early drafts of RICO did not include the securities fraud offense<sup>44</sup> because Congress did not add the

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41. See *infra* note 145 and accompanying text for a discussion of the appropriateness of looking to legislative history in the RICO securities fraud context.

42. Congress had contemplated creating a comprehensive crime statute such as RICO for a considerable amount of time prior to RICO's adoption in 1970. For example, in the 1930's, hearings conducted by Senator Royal S. Copeland first brought the problem of organized crime and racketeering under national scrutiny. Blakey, *supra* note 2, at 249 n.35. In the 1950's, the Special Committee to Investigate Organized Crime in interstate commerce (the Kefauver Committee) examined various proposals to combat organized crime. *Id.* at 249. In 1967, the President's Commission on Law Enforcement and the Administration of Justice (the Katzenbach Commission) released a detailed study outlining the pervasive influence of organized crime in American society. *Id.* at 251-53. This study significantly influenced the National Commission on the Reform of the Federal Criminal Law (Brown Commission) which created and sponsored RICO throughout the congressional enactment process. *Id.* at 253-58.

43. See, e.g., Mathews, *RICO in Securities Litigation*, *supra* note 16, at 944 (arguing that "RICO's legislative history does not reveal whether Congress had one or more particular provisions of the federal securities laws in mind when it crafted [the securities fraud] predicate offense"). See also Bridges, *supra* note 2, at 58 (identifying four possible interpretations of the securities fraud offense); MacIntosh, *supra* note 3, at 29 (contending that RICO's legislative history is not helpful in defining the boundaries of the securities fraud offense).

44. In 1967, Senator Roman L. Hruska introduced bills S. 2048 and S. 2049. These bills contained aspects of the Katzenbach Committee recommendations that the new crime statute utilize antitrust theories to combat organized crime. Blakey, *supra* note 2, at 253-54. The bills, even at this early stage, covered legitimate businesses in addition to organized crime. *Id.* at 254 n.48. They did not, however, contain a securities fraud predicate action.

In 1969, Senator McClellan introduced S. 30, the Organized Crime Control Act. *Id.* at 256. To accompany his proposal, Senator McClellan spoke at length about organized criminal conduct in business, government and unions. *Id.* Later in 1969, Senator Hruska introduced S. 1623, the Criminal Activities Profits Act which synthesized previous crime bills. *Id.* at 258-61. Interestingly, Hruska considered S. 1623 to be primarily a civil statute as evidenced by S. 1623's provisions for private equitable relief and treble damages. *Id.* at 261. However, neither S. 30 nor S. 1623 contained a securities fraud provision. Glanz, *supra* note 2, at 1536.

Finally, on April 18, 1969, Senator McClellan introduced S. 1861, the Corrupt Organizations Act. Blakey, *supra* note 2, at 262. S. 1861 did not originally contain provisions for private equitable relief or treble damages. *Id.* Then, during senate hearings on S. 30, Robert Haack, President of the New York Stock Exchange, testified to the pervasiveness of theft and fraudulent resale of securities in the securities exchanges. Glanz, *supra* note 2, at 1537-38. See also Arthur F. Mathews, *Report of the Ad Hoc Civil RICO Task Force*, 1985 A.B.A. SEC. CORP. BANKING & BUS. L. 100 [hereinafter Mathews,



provision until its final draft.<sup>45</sup> During congressional debate, interest groups criticized the broad reach of the securities fraud provision<sup>46</sup> while congressmen warned of the similarly broad impact of RICO "racketeering activity."<sup>47</sup> Therefore, Congress was fully aware of the

*Ad Hoc Task Force*]. Thus, when the bill came out of committee for final vote by the Senate, it contained the securities fraud provision. Glanz, *supra* note 2, at 1539.

The Senate passed S. 30 with the securities fraud provision; however, S. 30 lacked a treble damages provision. Mathews, *supra*, at 106. The bill then went to the House for final vote. During House debate on S. 30, the House added a treble damages provision. *Id.* at 119-20. Also, during House debate, critics of RICO offered extensive testimony against the statute. *Id.* at 116-19. See *infra* notes 46-47 for a discussion of the critics' testimony. The House overwhelmingly passed the bill complete with a treble damages provision and a securities fraud provision. The Senate concurred on the resulting bill without conference. Blakey, *supra* note 2, at 279-80.

45. See *supra* note 44 for a historical overview of the enactment of the securities fraud provision.

46. Even before the mail, wire and securities fraud provisions were added to RICO, the Justice Department objected to RICO on the grounds that it was too broad. See *Measures Relating to Organized Crime: Hearings on S. 30, S. 974, S. 975, S. 976, S. 1623, S. 1624, S. 1861, S. 2022, S. 2122 and S. 2292 Before the Subcomm. on Criminal Laws and Procedures of the Senate Comm. on the Judiciary, 91st Cong., 1st Sess. 404-07 (1969) [hereinafter Senate Hearings]*. The Justice Department feared that RICO "would result in a large number of unintended applications." Mathews, *RICO in Securities Litigation, supra* note 16, at 928 n.167 (citing *Senate Hearings* at 404-07).

During House debate, the Association of the Bar of the City of New York (ABCNY) also objected to the broad reach of RICO, especially the securities fraud offense. *Organized Crime Control, Hearings on S. 30 And Related Proposals Before Subcomm. No. 5 of The House Comm. on The Judiciary, 91st Cong., 2d Sess. 289 et. seq. (1970) [hereinafter House Hearings]*, cited in Mathews, *Ad Hoc Task Force, supra* note 44, at 111. The ABCNY testified that RICO "included as predicate offenses a number of criminal activities that were not characteristic[ ] . . . of organized crime, e.g., securities fraud." Mathews, *Ad Hoc Task Force, supra* note 44, at 111.

The New York County Lawyers Association also objected to the securities fraud predicate offense during House debate. The Association stated:

[A]gainst the background of expanding securities regulation, this definition [fraud in the sale of securities] could include the various officers, directors and employees of corporations and underwriters of securities who have been found guilty of fraud in the sale of securities in some of the recent Rule 10b-5 cases. Fraud in the sale of securities is simply not synonymous with racketeering activity.

*House Hearings, supra*, at 401.

Finally, the American Civil Liberties Union also objected to RICO during the debate. The ACLU objected to RICO on constitutional grounds because of the vagueness and breadth of predicate offenses composing "racketeering activity." Mathews, *Ad Hoc Task Force, supra* note 44, at 112 (citing *House Hearings*, at 499-501, 517-18).

47. Two influential members of Senate Judiciary Committee, Senators Edward M. Kennedy and Philip A. Hart, objected to S. 30 during Senate debate because it went "beyond organized criminal activity." Mathews, *Ad Hoc Task Force, supra* note 44, at 104. In addition, during House debate, Congressmen William F. Ryan, John Conyers, Jr. and Abner Mikva also objected to RICO's broad reach. Blakey, *supra* note 2, at 276

potentially limitless reach of the securities fraud offense, yet refused to explicitly include the 10b-5 purchaser-seller standing requirement in RICO.<sup>48</sup>

## II. 10B-5 SECURITIES LAW<sup>49</sup>

The purpose of the securities laws is to provide investors, both the experienced and novice, with full and truthful disclosure of all material information before making an investment decision.<sup>50</sup> The Securities Exchange Commission (SEC), in accordance with its rulemaking powers and § 10(b), promulgated Rule 10b-5 to further this purpose.<sup>51</sup> Originally used only as a prosecutorial tool of the SEC, courts have implied a private cause of action under 10b-5.<sup>52</sup>

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n.116 (citing H. R. REP. NO. 1549, 91st Cong. 2d Sess. 187 (1970)). These congressmen objected to RICO because it failed to "make [a] discrete segregation of mobsters." *Id.* Moreover, the congressmen objected to the treble damages provision, because it invited "disgruntled and malicious competitors to harass innocent businessmen engaging in interstate commerce." *Id.*

48. Professor Robert Blakey, the Chief Counsel of the Senate Subcommittee on Criminal Laws and Procedures during the creation and debate of RICO, concluded that the legislative history of RICO dictates that "Congress deliberately *extended* RICO to the general field of commercial and other fraud . . . and . . . Congress was well aware that it was creating important new federal criminal and civil remedies in a field traditionally occupied by common law fraud." Blakey, *supra* note 2, at 280.

Conversely, the ABA Ad Hoc Task Force was not present during the creation and debates on RICO. It examined the legislative history fifteen years after the Act's passage and concluded that "nothing in the legislative history suggests that Congress intended to replace existing express and implied private damage causes of action under the federal securities laws with the express RICO treble damage cause of action whenever two instances of mail, wire or securities fraud occurred in connection with a securities fraud transaction." Mathews, *Ad Hoc Task Force, supra* note 44, at 125-26.

49. General securities law is beyond the scope of this Note. A brief discussion of 10b-5 is necessary, however, to explain the origins of the purchaser-seller limitation. Moreover, courts have borrowed the rationale of the 10b-5 purchaser-seller limitation and applied it to RICO civil claims. *See, e.g., International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149, 153 (4th Cir. 1987) (applying the 10b-5 purchaser-seller limitations to RICO securities fraud); *Chief Consolidated Mining Co. v. Sunshine Mining Co.*, 725 F. Supp. 1191, 1194 (D. Utah 1989) (same).

50. The purpose of the Securities Exchange Act of 1934 was "to provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails, [and] to prevent inequitable and unfair practices on such exchanges and markets." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 728 (1975).

51. *See supra* notes 13-14 for the texts of § 10(b) and Rule 10b-5. The Commission enacted Rule 10b-5 in 1942. *Blue Chip Stamps*, 421 U.S. at 729.

52. Neither § 10(b) nor Rule 10b-5 provide express civil remedies for a securities

In the landmark case of *Blue Chip Stamps v. Manor Drug Stores*,<sup>53</sup> the Supreme Court enumerated the 10b-5 purchaser-seller limitation.<sup>54</sup> The Court held that in order to have standing to bring a 10b-5 claim, a plaintiff must actually purchase or sell securities.<sup>55</sup> The Court limited standing to sue under 10b-5 because of concern about the vexatious litigation that would result from a broader class of plaintiffs.<sup>56</sup>

In the years since *Blue Chip Stamps*, courts have further refined the 10b-5 purchaser-seller requirement to meet new factual situations.<sup>57</sup> Much of this refinement has focused on the 10b-5 phrase "in connection with," and involved the nexus between the securities transaction and the fraud. Courts have expanded 10b-5 standing by reading "in connection with" as an "elastic nexus element."<sup>58</sup> In essence, the "in connection with" phrase permits plaintiffs to sue defendants even where the defendant did not participate in an actual securities transaction.<sup>59</sup> However, despite the elastic nature of this phrase, courts have

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fraud violation. *Blue Chip Stamps*, 421 U.S. at 729-30. In *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), the district court first implied a private cause of action in 10b-5. The court based its decision on general tort law, the remedial purposes of the Act and § 29(b) of the 1934 Securities Exchange Act, which deems voidable any contract made in violation of the Act. *Id.* at 514. In *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952), the court followed *Kardon*; however, in accordance with 10b-5's language, the *Birnbaum* court limited standing to sue under an implied cause of action to actual purchasers or sellers of securities. *Id.* at 463-64. The Supreme Court affirmed the *Birnbaum* rule in *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12-13 (1971).

53. 421 U.S. 723 (1974).

54. *Id.* at 749.

55. *Id.*

56. *Id.* at 740. The *Blue Chip Stamps* Court noted that the fear of vexatious litigation has two grounds. *Id.* The first is a concern that lawsuits will disrupt normal business activity by making accusations of fraud designed to receive a large settlement. *Id.* Secondly, by broadening the 10b-5 standing requirement, plaintiffs would have difficulty demonstrating, and juries would have difficulty understanding, deceptive practices. *Id.* at 743. The Court stated that without the purchaser-seller limitation:

[P]laintiff's proof would not be that he purchased or sold stock . . . but instead that he decided *not* to purchase or sell stock. Plaintiff's entire testimony could be dependent upon uncorroborated oral evidence of many of the crucial elements of his claim, and still be sufficient to go to the jury.

*Id.* at 746.

57. See, e.g., *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 473-74 (1977) (limiting 10b-5 causes of action to claims of manipulation or deception).

58. Mathews, *RICO in Securities Litigation*, *supra* note 16, at 945.

59. See, e.g., *Norris v. Wirtz*, 719 F.2d 256, 260 (7th Cir. 1983); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 860 (2d Cir. 1968).

consistently interpreted 10b-5 to require that the plaintiff purchased or sold securities based upon the defendant's fraudulent conduct.<sup>60</sup> Thus, the rationale underlying the purchaser-seller limitation remains steadfast, regardless of subtle changes.

Neither RICO's plain language nor its legislative history expressly incorporates the 10b-5 standing limitation into RICO's securities fraud provision. However, courts generally have read the 10b-5 standing limitation into the RICO securities fraud provision.<sup>61</sup> Courts echo the *Blue Chip Stamps* Court's concern over the danger of vexatious litigation when they engraft the 10b-5 standing limitation onto RICO securities fraud offenses.<sup>62</sup>

### III. JUDICIAL CONSIDERATION OF THE PURCHASER-SELLER LIMITATION IN RICO SECURITIES FRAUD

#### A. Introduction

Three judicial factions have addressed whether the RICO securities fraud offense contains a 10b-5 purchaser-seller limitation. The first faction applies the 10b-5 standing requirement to RICO securities fraud and allows only purchasers or sellers of securities to bring suit.<sup>63</sup> The

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60. See generally ARNOLD S. JACOBS, LITIGATION AND PRACTICE UNDER RULE 10b-5, § 38.01(d) (discussing inroads into the purchaser-seller limitation).

61. See, e.g., *International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149, 152 (4th Cir. 1987) (applying the 10b-5 purchaser-seller limitation to RICO securities fraud); *Chief Consolidated Mining Co. v. Sunshine Mining Co.*, 725 F. Supp. 1191, 1194 (D. Utah 1989) (same); *Kravetz v. Brukenfeld*, 591 F. Supp. 1383 (S.D.N.Y. 1984) (same); see also *Lou v. Belzberg*, 728 F. Supp. 1010 (S.D.N.Y. 1990) (plaintiff has standing to bring RICO claim where he alleges violations of § 13(d)); *First Pacific Bancorp v. Bro*, 847 F.2d 542 (9th Cir. 1988) (holding that plaintiff lacks standing to sue for RICO securities fraud where his § 13(d) claim does not allege that he purchased or sold securities); but cf. *Securities Investor Protection Corp. v. Vigman*, 908 F.2d 1461, 1467 (9th Cir. 1990) (holding that a RICO securities fraud claim is not limited by the purchaser-seller requirement); *Warner v. Alexander Grant & Co.*, 828 F.2d 1528, 1530 (11th Cir. 1987) (same).

62. See *infra* notes 66-104 and accompanying text for a discussion of courts imposing the 10b-5 purchaser-seller limitation onto RICO securities fraud.

63. See, e.g., *Zepkin*, 812 F.2d at 152 (stating in dicta that 10b-5 purchaser-seller limitation applies to RICO securities fraud); *Brannon v. Eisenstein*, 804 F.2d 1041, 1043 (8th Cir. 1986) (dismissing a RICO claim because the plaintiffs failed to meet the 10b-5 purchaser-seller requirement); *Chief Consol. Mining Co.*, 725 F. Supp. at 1194 (holding that standing to sue under RICO is limited to actual purchasers or sellers of securities); *Hanna Mining Co. v. Norcen Energy Res., Ltd.*, [1982 Decisions] Fed. Sec. L. Rep. (CCH) ¶ 98,742, at 93,738 (N.D. Ohio June 11, 1982) (holding that RICO encompasses fraud in the purchase and sale of securities); *Spencer Cos., Inc. v. Agency*

second faction further limits RICO securities fraud standing and relies upon the literal language of RICO to grant standing only where the defendant defrauds the plaintiff in the actual sale of securities.<sup>64</sup> The third faction rejects entirely the artificial limits on RICO securities fraud and grants standing broadly.<sup>65</sup>

### B. 10b-5 Faction

In *International Data Bank, Ltd. v. Zepkin*,<sup>66</sup> the Fourth Circuit Court of Appeals, in dicta, applied the 10b-5 standing requirement to RICO securities fraud.<sup>67</sup> In *Zepkin*, the defendants misrepresented costs incurred in starting a company to a group of investors.<sup>68</sup> The investors gained control of the company and sued the defendants based

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Rent-A-Car, Inc., [1981-82 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,361, at 92,215 (D. Mass. Nov. 17, 1981) (same).

64. See *In re Par Pharmaceutical, Inc. Sec. Litig.*, 733 F. Supp. 668, 684 (S.D.N.Y. 1990) (holding that "fraud in the sale of securities" is limited to sale transaction fraud only).

65. See, e.g., *Securities Investor Protection Corp. v. Vigman*, 908 F.2d 1461, 1467 (9th Cir. 1990) (holding that RICO does not require a plaintiff to be a purchaser or seller of securities); *Warner v. Alexander Grant & Co.*, 828 F.2d 1528, 1530 (same); see also *Pelletier v. Zweifel*, 921 F.2d 1465, 1511 n.80 (11th Cir. 1991) (following *Vigman* and stating that "the standing requirements of the securities laws do not apply to civil RICO actions based upon predicate acts of securities fraud").

66. 812 F.2d 149 (4th Cir. 1987).

67. *Id.* at 152. The plaintiff alleged that the defendant committed two violations of 10b-5. The plaintiff further claimed that these two 10b-5 violations satisfied the predicate act requirement under RICO. *Id.* at 151. The *Zepkin* court determined that the plaintiff's 10b-5 claims were defective because they were "in connection with" neither the purchase nor the sale of securities. *Id.* at 152-54. Thus, because the plaintiffs premised their RICO claim on 10b-5 predicate acts, the court did not have to address whether RICO securities fraud contains a standing limitation analogous to 10b-5. *Id.* at 152. The court stated that "[w]e need not decide whether the term 'fraud in the sale of securities' . . . merely incorporates by reference the standing provisions of securities fraud statutes or whether it also limits of its own force RICO standing to the actual parties to a sale." *Id.* at 152. Despite this qualification, the court addressed the issue in depth and strongly suggested that RICO securities fraud standing is limited "of its own force" by the 10b-5 standing limitation. *Id.* See, e.g., *Chief Consolidated Mining Co. v. Sunshine Mining Co.*, 725 F. Supp. 1191, 1194 (D. Utah 1989) (citing *Zepkin* for the proposition that RICO securities fraud is limited by 10b-5 standing requirement).

68. 812 F.2d at 150. The defendants raised capital for their international trade company through outside investors. *Id.* In the offering prospectus, the defendants claimed they paid for certain equipment in advance. *Id.* Plaintiffs, ten outside investors, purchased stock in the company and subsequently contributed funds to repay the defendants for their initial outlay. *Id.* Later, when the outside investors took over the company, they discovered that defendants falsified these initial expenses. *Id.* at 150-51.

upon two interrelated theories. First, the plaintiffs argued that the defendants fraudulently induced payment in violation of 10b-5.<sup>69</sup> Second, the investors claimed that the 10b-5 securities fraud constituted RICO racketeering activity.<sup>70</sup>

The *Zepkin* court held that the plaintiffs did not have standing to bring a 10b-5 claim because their reimbursement to defendants was not a purchase or sale of securities.<sup>71</sup> Because the plaintiffs predicated their RICO claim on the facially deficient 10b-5 claim, the court found the RICO claim similarly deficient.<sup>72</sup> In dismissing the RICO claim, however, the court discussed whether RICO securities fraud contains a purchaser-seller limitation analogous to 10b-5.<sup>73</sup>

The court compared the language of § 1961(1)(D) of RICO with Rule 10b-5's language<sup>74</sup> and found that RICO's language "fraud in the sale of securities" was narrower than 10b-5's language "fraud in connection with the purchase or sale of any security."<sup>75</sup> The court determined that the absence of both the word "purchase" and the phrase "in connection with" from § 1961(1)(D) was significant.<sup>76</sup> The court reasoned that Congress was aware of the 10b-5 purchaser-seller limitation when it enacted RICO and concluded that Congress would not unceremoniously change that longstanding limitation.<sup>77</sup>

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69. *Id.* at 151.

70. *Id.* Plaintiffs claimed RICO securities fraud by alleging at least two violations of the securities fraud predicate offense which could amount to racketeering activity within the meaning of RICO. *Id.* However, the substantive violations were of 10b-5. *Id.* at 152. Therefore, the court first examined the underlying 10b-5 securities claim before reaching the RICO claim. *Id.* at 151. See *supra* notes 26-38 and accompanying text for a discussion of the mechanics of RICO.

71. 812 F.2d at 151-52. The plaintiffs first purchased securities from the defendants. Only later did the plaintiffs repay the defendants for the expenses fraudulently listed in the offering prospectus. The two transactions were distinct and the repayment did not involve securities. *Id.*

72. *Id.* at 151.

73. *Id.* at 152.

74. See *supra* notes 14 & 31 for the respective texts of 10b-5 and § 1961(1)(D).

75. 812 F.2d at 152. The court stated that "[t]he statutory language . . . 'fraud in the sale of securities' is . . . narrow and suggests the pivotal role of the actual sales transaction." *Id.* See *infra* notes 146-47 and accompanying text for a discussion comparing the language of RICO with that of 10b-5.

76. 812 F.2d at 152.

77. *Id.* Congress enacted RICO "against the developed backdrop of almost forty years of federal securities law. . . . If Congress had intended the drastic result of overturning [the purchaser-seller limitation], it surely would have done so in a more explicit way." *Id.*

Although the court recognized that 10b-5 is a judicially-implied civil cause of action, as opposed to RICO which is an express civil cause of action, the court applied the rationale behind the 10b-5 purchaser-seller limitation to RICO.<sup>78</sup> The court opined that the danger of "vexatious litigation"<sup>79</sup> is greater in RICO securities fraud claims than in 10b-5 claims because of RICO's treble damage provision.<sup>80</sup>

In *Chief Consol. Mining Co. v. Sunshine Mining Co.*,<sup>81</sup> the District Court of Utah followed the *Zepkin* dicta<sup>82</sup> and held that RICO securities fraud standing is limited by 10b-5 standing requirements.<sup>83</sup> In *Chief*, the plaintiff sold mineral rights to the defendant in exchange for royalties on the sale of ore mined at the site.<sup>84</sup> The defendant then filed a stock prospectus representing that it would mine the property in the near future.<sup>85</sup> The plaintiff alleged that the prospectus was misleading because the defendant never intended to mine the site.<sup>86</sup> Therefore, the plaintiff brought an action for securities fraud under both 10b-5 and RICO.<sup>87</sup>

The *Chief* court held that the plaintiff did not have standing to sue under RICO because they were neither purchasers nor sellers of securities.<sup>88</sup> The court adopted the *Zepkin* court's interpretation of Congress' intent when enacting RICO.<sup>89</sup> In addition, the *Chief* court upheld the *Zepkin* court's policy rationale of preventing vexatious litigation.<sup>90</sup> The court reasoned that RICO should not enable plaintiffs to

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78. *Id.* at 153.

79. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 740 (1975).

80. 812 F.2d at 153. The court reasoned that "[t]he larger potential recovery under RICO enhances the 'settlement value' and 'nuisance' potential of a securities fraud action." *Id.* (citing *Blue Chip Stamps*, 421 U.S. at 740-43).

81. 725 F. Supp. 1191 (D. Utah 1989).

82. *Id.* at 1194.

83. *Id.* The issue was one of first impression in the Tenth Circuit. *Id.*

84. *Id.* at 1192-93.

85. 725 F. Supp. at 1193.

86. *Id.* This misrepresentation would increase the value of the defendant's stock, especially where, as here, the defendant represented the property as valuable. *Id.* at 1192-93.

87. *Id.* at 1193.

88. *Id.* at 1195.

89. 725 F. Supp. at 1194. *See supra* notes 66-80 and accompanying text for a discussion of *Zepkin*.

90. 725 F. Supp. at 1194.

contravene the longstanding 10b-5 purchaser-seller limitation.<sup>91</sup>

Finally, the court rejected the plaintiff's argument that RICO's civil securities fraud must be interpreted consistently with the criminal securities fraud provisions of RICO<sup>92</sup> and 10b-5, both of which lack the purchaser-seller requirement.<sup>93</sup> The court noted that the purchaser-seller limitation in 10b-5 applies only to civil 10b-5 actions, not to 10b-5 criminal actions.<sup>94</sup> Therefore, the *Chief* court determined that its limitation on civil RICO was consistent with existing securities law.<sup>95</sup>

In *Brannan v. Eisenstein*,<sup>96</sup> the Eighth Circuit Court of Appeals also applied the 10b-5 purchaser-seller limitation to RICO securities fraud.<sup>97</sup> However, the Eighth Circuit invoked a stricter limitation on the RICO civil cause of action than either *Chief* or *Zepkin*. In *Brannan*, the plaintiffs, directors of a petroleum company, alleged that the defendants fraudulently induced<sup>98</sup> the directors to sell interests in oil and gas leases.<sup>99</sup> The court dismissed the directors' 10b-5 claim be-

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91. *Id.*

92. *Id.* at 1194-95. The plaintiff noted that civil RICO utilizes the same substantive offense, § 1961(1)(D), as criminal RICO. *Id.* at 1194. The plaintiff thus argued that, since the language of criminal and civil RICO is the same, the language cannot be interpreted one way in the criminal context and another way in the civil context. *Id.*

93. See *infra* notes 163-64 and accompanying text for a discussion of RICO criminal securities fraud and the purchaser-seller limitation.

94. 725 F. Supp. at 1195.

95. *Id.* The court cited *Moss v. Morgan Stanley, Inc.*, 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984), where the court dismissed a civil RICO action for lack of standing even though the defendant had been convicted criminally of RICO securities fraud under the same allegations. 719 F.2d at 11-12. See *infra* notes 161-69 and accompanying text for a discussion of criminal versus civil RICO.

96. 804 F.2d 1041 (8th Cir. 1986).

97. *Id.* at 1045-46.

98. *Id.* at 1043. The inducement was allegedly fraudulent because the defendants purposely failed to inform the directors of a petroleum company that the interest must be registered under Missouri blue sky laws prior to a sale. *Id.* The defendants allegedly purchased the interest with knowledge of the Missouri laws. *Id.* Subsequent to the sale, the defendants sued the directors in Missouri state court and sought to rescind the sale of the oil and gas interests on the grounds that the sale violated the blue sky laws. The defendants won this case and an appeal in the Missouri Court of Appeals, *Dunn v. Bemor Petroleum, Inc.*, 680 S.W.2d 304 (Mo. Ct. App. 1984). As a result, the directors suffered damages due to the rescission of the sale of the oil interests. 804 F.2d at 1043. The directors then initiated this suit to recover damages from the rescission, alleging that the rescission was part of a scheme to defraud their company. *Id.*

99. *Id.*



cause they did not actually sell any securities.<sup>100</sup> Accordingly, the court also dismissed the RICO securities fraud claim.<sup>101</sup>

Furthermore, the court dismissed the directors' RICO wire fraud claim because "the same conduct cannot constitute a fraudulent scheme giving rise to a wire fraud claim."<sup>102</sup> Therefore, the *Brannan* court held that, when allegedly fraudulent conduct fails the 10b-5 standing requirement, the same conduct cannot be the basis for another predicate offense.<sup>103</sup> In so holding, the court sought to prevent the circumvention of the 10b-5 standing requirement.<sup>104</sup> Thus, the Eighth Circuit implied that the 10b-5 purchaser-seller requirement limits not only RICO securities fraud, but also all other RICO fraud offenses.<sup>105</sup>

### C. *Literal Language Faction*

In *In re Par Pharmaceutical Inc. Sec. Litig.*,<sup>106</sup> the United States District Court for the Southern District of New York<sup>107</sup> limited RICO

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100. 804 F.2d at 1045. The court found that the directors did "not allege that they were the actual sellers of the securities in question . . . , they simply allege[d] that the state court held them to be sellers" of securities. *Id.* at 1046.

101. *Id.* The court reasoned that because it dismissed the securities fraud claim, the directors cannot rely upon that conduct as the basis of a RICO claim. *Id.*

102. *Id.* at 1047. The court neither explained nor supported its holding with case law.

103. *Id.* In other words, where fraudulent conduct does not amount to securities fraud because the fraud was not "in connection with" a purchase or sale, that same fraudulent conduct cannot amount to mail fraud or wire fraud. *Id.*

104. *Id.* See Mathews, *RICO in Securities Litigation*, *supra* note 16, at 948 (stating that plaintiff cannot plead another predicate offense in order to "plug the standing 'loophole' in the securities fraud claim").

105. The Eighth Circuit Court of Appeals followed *Brannan* in *Forkin v. Rooney Pace, Inc.*, 804 F.2d 1047 (8th Cir. 1986). In *Forkin*, the plaintiffs alleged that the defendants fraudulently failed to disclose that the securities which they sold to plaintiffs were not registered for sale in Illinois. 804 F.2d at 1048-49. Similar to *Brannan*, the transaction violated state securities law and ended in rescission. *Id.* at 1049. However, in *Forkin*, the court held that the appellees' conduct was not manipulative or deceptive under 10b-5. *Id.* at 1050. Therefore, the court dismissed the 10b-5 claim. *Id.* at 1051. The court then followed *Brannan* and dismissed not only the appellants' securities fraud claim, but also their wire and mail fraud claims. *Id.* "[O]ur finding with respect to the federal securities law claims renders the RICO claims insufficient as a matter of law because the appellants' allegations of racketeering activity are predicated on the same conduct as the securities fraud claims." *Id.* at 1051.

106. 733 F. Supp. 668 (S.D.N.Y. 1990).

107. Courts in New York's southern district have been consistent on the issue whether RICO securities fraud contains a 10b-5 limitation. In *Kravetz v. Brukenfeld*,

securities fraud standing to an even more narrow class of plaintiffs than the 10b-5 faction. The *Par* court held that RICO's literal language limited RICO securities fraud standing to plaintiffs defrauded by the defendants in the actual sale transaction.<sup>108</sup> In *Par*, a group of investors sued the board of directors of a drug manufacturing company for violations of 10b-5 and RICO securities fraud.<sup>109</sup> The plaintiffs alleged that the defendants bribed Federal Drug Administration officials to gain expedited approval of new drugs which, in turn, would increase company profits.<sup>110</sup> The plaintiffs purchased company stock in reli-

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591 F. Supp. 1383, 1390 (S.D.N.Y. 1984), Judge Goetel concluded that a RICO securities fraud claim predicated on a 10b-5 violation requires fraud in the sale of securities. Since the court dismissed the plaintiff's 10b-5 claim for lack of standing, the court dismissed the RICO claim as well. *Id.* at 1388, 1390. Apparently, the plaintiff neglected to argue that RICO securities fraud lacks the purchaser-seller requirement, because the court did not supply any rationale for its finding.

Similarly, in *Par*, Judge Patterson held that standing to sue under RICO securities fraud is limited to fraudulent conduct committed by the defendant in actual sales transactions. *Par*, 733 F. Supp. at 684. Six months after *Par*, in *Viacom Int'l Inc. v. Icahn*, 747 F. Supp. 205, 210 (S.D.N.Y. 1990), Judge Patterson held that "[p]laintiff must have been directly involved in either the purchase or sale of the securities in the Rule 10b-5 allegations to have standing under RICO to assert a Rule 10b-5 violation as a predicate act of racketeering." *Id.* Interestingly, Judge Patterson did not cite *Par* in *Viacom*. *Id.*

Finally, in *Beres v. Thomson McKinnon Secs., Inc.*, [1990-91 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,722 (S.D.N.Y. December 20, 1990), Judge Kram dismissed the plaintiff's RICO securities fraud claim because the plaintiff neither purchased nor sold securities. The court found the plaintiff's 10b-5 claim deficient because the plaintiff had not purchased securities, but assertedly lost "a mere . . . opportunity to purchase securities." *Id.* at 98,403. The court dismissed the RICO securities fraud claim as a matter of law because the 10b-5 claim was deficient. *Id.* at 98,404. *Beres* thus follows *Viacom* and *Par* because *Beres* suggests that a purchase or a sale of securities is sufficient to allege a RICO securities fraud claim.

The consistency within the Southern District of New York is surprising, considering the Second Circuit Court of Appeals' squeamish treatment of the RICO standing issue in *Moss v. Morgan Stanley, Inc.*, 719 F.2d 5 (2d Cir. 1983). In *Moss*, the court expressly deferred "this complex and far-reaching question" and did "not delineate RICO's definition of 'fraud in the sale of securities.'" *Id.* at 18 n.14. In *Moss*, the court dismissed the private 10b-5 cause of action against defendants criminally convicted under 10b-5 in a previous decision, *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981). The *Moss* court held that the plaintiff lacked standing to sue the defendant for insider trading under 10b-5 because the defendants owed no duty of disclosure to the plaintiff. *Moss*, 719 F.2d at 15. As a result, the court invalidated the RICO claim without addressing the RICO standing issue. *Id.* at 19.

108. *Par*, 733 F. Supp. at 683-84.

109. *Id.* at 671-72. The plaintiffs also sued for violation of § 20(a) of the 1934 Securities Exchange Act, common law fraud and deceit, and negligent misrepresentation. *Id.* at 672.

110. *Id.* at 672-73. *Par*'s Annual Report stated that "the ability of the Company to

ance on the defendants' misrepresentations that "legitimate business acumen" secured FDA approval.<sup>111</sup>

The *Par* court partially denied the defendants' motion to dismiss the 10b-5 claim.<sup>112</sup> However, the court sustained the defendants' motion to dismiss the RICO securities fraud claim because the plaintiffs did not allege that defendants sold securities.<sup>113</sup> The court focused on the plain language of § 1961(1)(D), "fraud in the sale of securities."<sup>114</sup> The *Par* court reasoned that the absence in RICO of any 10b-5 language, including "purchase" or "in connection with," indicated that Congress intended to limit RICO securities fraud to fraud which occurs in actual sales transactions.<sup>115</sup> Thus, the court concluded that the elastic "in connection with" clause is inapplicable to RICO securities fraud.<sup>116</sup> This conclusion significantly narrowed RICO securities

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continually introduce new products as quickly as possible . . . is essential to the maintenance of its gross profit margins." *Id.* at 672 n.4.

111. *Id.* at 673.

112. 733 F. Supp. at 679. The court dismissed the 10b-5 claim that the defendants misled the plaintiffs by failing to disclose a pending Justice Department investigation into the bribery scheme. *Id.* at 678. The court found that the defendants' failure to speculate about the outcome of the investigation was not misleading within the meaning of 10b-5. *Id.* The court stated that plaintiffs were entitled to a jury trial, however, to prove their 10b-5 claim that the defendants lied about their success in obtaining FDA approvals. *Id.* at 679.

113. *Id.* at 684.

114. The court stated that "[b]y the plain language of § 1961(1)(D), securities fraud is only a predicate offense if the fraud occurs in the actual sale of a security." *Id.* at 683.

115. *Id.* The court found that:

It is reasonable to assume that Congress, had it wanted to make the RICO predicate acts coextensive with § 10(b), would have used the same or similar language in § 1961(1)(D) that it used in § 10(b). Had Congress intended RICO to be coextensive with § 10b, it certainly knew how to do so.

*Id.*

116. 733 F. Supp. at 684. The *Par* court concluded that:

The "in connection with" language provides standing only to plaintiffs who have either purchased or sold securities, but it does not limit liability to defendants who sold or bought from the plaintiffs. Thus, under the "in connection with" requirement, a defendant may be held liable even though he was not a party to a securities transaction. This concept arose directly out of the "in connection with" language. The language in § 1961(1)(D) — "fraud in the sale of securities" — is much less susceptible to such an interpretation, and to stretch the language so far in the absence of any evidence that Congress intended such a result would be an act of judicial legislation.

*Id.* at 683-84.

fraud standing beyond 10b-5 limits.<sup>117</sup>

#### D. *Broad Application Faction*

In *Securities Investor Protection Corp. v. Vigman*,<sup>118</sup> the Ninth Circuit Court of Appeals interpreted RICO broadly and held that RICO securities fraud is not subject to the 10b-5 purchaser-seller limitation.<sup>119</sup> In *Vigman*, the defendant allegedly manipulated stock prices by issuing misleading press releases,<sup>120</sup> purchasing large blocks of stock and selling the stock in small lots,<sup>121</sup> and parking stock in his account.<sup>122</sup> The plaintiff<sup>123</sup> asserted a RICO securities fraud claim based upon violations of 10b-5.<sup>124</sup> The district court dismissed the plaintiff's RICO claim because plaintiff did not meet the 10b-5

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117. See *supra* note 58 and accompanying text for a discussion of the elastic "in connection with" clause from 10b-5.

118. 908 F.2d 1461 (9th Cir. 1990), *cert. granted in part sub nom.* Holmes v. SIPC, 111 S. Ct. 1618 (1991).

119. *Id.* at 1467. The Ninth Circuit is not the only court to hold that RICO securities fraud is not limited by the 10b-5 purchaser-seller limitation. In *Warner v. Alexander Grant & Co.*, 828 F.2d 1528, 1530 (11th Cir. 1987), the Eleventh Circuit Court of Appeals also held that RICO securities fraud is not subject to the purchaser-seller limitation. In *Warner*, the court affirmed the district court's dismissal of the plaintiff's 10b-5 claim on the grounds that the alleged fraud did not occur "in connection with" a purchase or sale of securities. *Id.* at 1530. However, with respect to the plaintiff's RICO securities fraud claim, the court found that "RICO ha[d] no requirement analogous to the 'purchase or sale' requirement of the federal securities laws." *Id.* The court further stated that a plaintiff need only show injury resulting from the RICO violation. *Id.* See also *Pelletier v. Zweifel*, 921 F.2d 1465, 1511 n.80 (11th Cir. 1991) (relying on *Vigman* finding that RICO securities fraud is not limited to purchaser-seller limitation).

120. 908 F.2d at 1464. The defendant allegedly issued false and misleading press releases about new products his firm was preparing to market. *Id.*

121. *Id.* Through his actions, defendant allegedly created an appearance of an active trading market for the stock. *Id.*

122. *Id.* "Parking" is a manipulative device which circumvents the net capital requirements of the National Association of Securities Dealers (NASD). *Id.* at 1464 n.4. NASD requires brokerage firms to file monthly reports of their net capital and to discount in value any stock the firm has in its own account. *Id.* To circumvent this discount requirement, a brokerage firm allegedly "parked" stock in the defendant's account by selling the stock to the defendant at market price and then buying it back after filing the NASD report. *Id.*

123. The plaintiff is a nonprofit corporation composed of registered brokers and dealers. *Id.* at 1463. Congress created the Securities Investor Protection Corporation (SIPC) in 1970 to provide more effective protection to customers of brokers and dealers and members of national securities exchanges. *Id.*

124. *Id.* at 1464.

purchaser-seller requirement for standing.<sup>125</sup> On appeal, the Ninth Circuit reversed and held that the 10b-5 purchaser-seller limitation does not apply to RICO claims based on alleged securities fraud under 10b-5.<sup>126</sup>

The *Vigman* court first examined the standing issue by comparing the language of the RICO securities fraud offense with that of 10b-5.<sup>127</sup> The court found that, on its face, RICO securities fraud did not require a plaintiff to be a purchaser or seller.<sup>128</sup> In contrast, the court noted that 10b-5 securities fraud is expressly limited to fraud "in connection with the purchase or sale of securities."<sup>129</sup>

In addition, the court distinguished RICO from 10b-5, noting that RICO securities fraud is an express civil cause of action, whereas 10b-5 is a judicially implied cause of action.<sup>130</sup> The court reasoned that, while the Supreme Court has imposed judicial limitations on the implied 10b-5 cause of action,<sup>131</sup> the Court has explicitly declined to limit express causes of action.<sup>132</sup>

Finally, the Ninth Circuit found that Congress intended courts to interpret RICO broadly.<sup>133</sup> The court noted that Congress purposely worded RICO broadly<sup>134</sup> by including a liberal construction provision in RICO which mandated an "expansive approach" to judicial interpretation.<sup>135</sup> Thus, pursuant to the text of § 1964(c), the *Vigman* court granted standing to sue to "any person injured in his business or prop-

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125. 908 F.2d at 1465.

126. *Id.* at 1467.

127. In beginning its statutory analysis, the court first looked to the plain language of RICO. *Id.* at 1466.

128. *Id.* "Any plaintiff who is injured 'by reason of' fraud in the sale of securities may sue [under RICO]." *Id.*

129. 908 F.2d at 1466.

130. *Id.*

131. *Id.* The court cited *Blue Chip Stamps* as the seminal case imposing the purchaser-seller limitation on 10b-5 private actions. See *supra* notes 53-56 and accompanying text for a discussion of *Blue Chip Stamps*.

132. 908 F.2d at 1466. The court noted that it is inappropriate for a court to impose a standing requirement because it disagrees with Congress "about the wisdom of creating so expansive a liability." *Id.* (quoting *Blue Chip Stamps*, 421 U.S. at 748-49).

133. 908 F.2d at 1466.

134. *Id.*

135. *Id.* The *Vigman* court relied upon the Supreme Court's decision in *Sedima, S.P.L.R. v. Imrex Co.*, 473 U.S. 479 (1985). "RICO is to be read broadly. This is the lesson not only of Congress' self-consciously expansive language and overall approach, but also of its express admonition that RICO is to 'be liberally construed to effectuate its

erty by reason of" securities fraud.<sup>136</sup>

#### IV. ANALYSIS OF CASE LAW

##### A. *The Plain Language of RICO*

When interpreting RICO, courts first examine the plain language of the statute.<sup>137</sup> The express language of the RICO securities fraud predicate offense lacks a purchaser-seller standing limitation.<sup>138</sup> In RICO, Congress granted standing to bring a securities fraud claim to "any person injured . . . by reason of"<sup>139</sup> "fraud in the sale of securities."<sup>140</sup> This broad definition of standing does not include any reference to the purchaser-seller requirement.<sup>141</sup> Courts that limit RICO securities fraud standing to sue by including a purchaser-seller requirement disregard RICO's express standing provision.<sup>142</sup>

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remedial purposes.'" *Sedima*, 473 U.S. at 497-98 (citation omitted) (quoting RICO, Pub. L. No. 91-452, § 904(a), 84 Stat. 947 (1970)).

136. 908 F.2d at 1466 (quoting RICO, 18 U.S.C. § 1964(c) (1988)). In *Bennett v. Centerpoint Bank*, 761 F. Supp. 908, 914 (D.N.H. 1991), the district court noted that the *Vigman* court's holding does not grant standing to anyone to bring a RICO securities fraud claim. Rather, the court stated that *Vigman* requires the plaintiff to show injuries "by reason of" the securities fraud. *Id.* In *Bennett*, the court did not rule on whether the purchaser-seller requirement limits RICO securities fraud. Instead, the court dismissed the plaintiff's RICO securities fraud claim because the plaintiff's injuries were not caused "by reason of" the defendant's alleged securities fraud. *Id.* at 915.

Similarly, in *Pelletier v. Zweifel*, 921 F.2d 1465, 1510 n.80, the Eleventh Circuit Court of Appeals noted that *Vigman* does not grant open-ended standing to plaintiffs. Instead, "someone, even if not the civil RICO plaintiff, must have been a purchaser or seller of securities" for the predicate act to have actually occurred. *Id.*

137. See *United States v. Turkette*, 452 U.S. 576, 593 ("The language of the statute . . . [is] the most reliable evidence of [Congress'] intent."). See also *Blakey*, *supra* note 2, at 240 (stating that the Supreme Court has repeatedly noted that the scope of a statute must first be determined by examining its text).

138. See *supra* notes 26-38 and accompanying text for a discussion of the plain language of the RICO securities fraud predicate offense.

139. 18 U.S.C. § 1964(c) (1988). RICO defines any "person" as "any individual or entity capable of holding a legal or beneficial interest in property." *Id.* § 1961(3).

140. 18 U.S.C. § 1961(1)(D) (1988).

141. "If Congress wanted to narrow the class of persons entitled to sue, . . . narrowing the definition of 'person' in this section was all it took to achieve that objective . . ." G. Robert Blakey & Thomas A. Perry, *An Analysis of the Myths That Bolster Efforts to Rewrite RICO and the Various Proposals for Reform: "Mother of God—Is This the End of RICO?"*, 43 VAND. L. REV. 851, 935 n.232 (1990).

142. See *International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149, 151 (4th Cir. 1987) (omitting § 1964(c) from analysis and interpreting "fraud in the sale of securities" alone); *In re Par Pharmaceutical, Inc. Sec. Litig.*, 733 F. Supp. 668 (S.D.N.Y. 1990)

In addition, both the literal language faction and the 10b-5 faction ignore the plain language of RICO's liberal construction provision.<sup>143</sup> In that provision, Congress mandated a broad judicial interpretation of RICO because of RICO's remedial nature.<sup>144</sup> Thus, the plain language of RICO contravenes the judicial imposition of a purchaser-seller limitation.<sup>145</sup>

While ignoring RICO's plain language, the literal language faction also incorrectly compares the word "in," from RICO's "fraud in the sale of securities" provision with 10b-5's "in connection with" language.<sup>146</sup> This faction finds "in" to be narrower than "in connection

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(same); Chief Consol. Mining Co. v. Sunshine Mining Co., 725 F. Supp. 1191, 1193-94 (D. Utah 1989) (same); Kravetz v. Brukenfeld, 591 F. Supp. 1383, 1389-90 (S.D.N.Y. 1984) (same); Hanna Mining Co. v. Norcen Energy Res., Ltd., [1982 Decisions] Fed. Sec. L. Rep. (CCH) ¶ 98,742, at 93,738 (same) (N.D. Ohio June 11, 1982); Spencer Cos., Inc. v. Agency Rent-A-Car, Inc. [1981-82 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,361, at 92,215 (D. Mass. Nov. 17, 1981) (same); *But cf.* Securities Investor Protection Corp. v. Vigman, 908 F.2d 1461, 1466 (9th Cir. 1990) (relying upon § 1964(c) to grant standing to sue under the RICO securities fraud predicate offense).

143. *See supra* notes 17-18 and accompanying text for a discussion of the liberal construction provision.

144. *Id.*

145. "If the statutory language is unambiguous, in the absence of a 'clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive.'" *United States v. Turkette*, 452 U.S. 576, 580 (1981) (quoting *Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)). Courts may only resort to legislative history where the statutory language is "inescapably ambiguous." *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384, 395 (1951) (Jackson, J., concurring). The RICO securities fraud provision is unambiguous and gives standing to plaintiffs who can show a causal connection between the pattern of racketeering activity and the damages suffered. *See MacIntosh, supra* note 3, at 36. RICO simply lacks any language suggesting a limitation similar to 10b-5. *Id.* at 35. Thus, courts err when they allow "an expression of policy to override what appear to be the clear words of the statute." *Id.*

146. *See supra* note 136-40 and accompanying text for a discussion comparing the language of the two fraud provisions. *See also In re Par Pharmaceutical, Inc. Sec. Litig.*, 733 F. Supp. 668, 683 (S.D.N.Y. 1990) ("'[F]raud in the sale of securities' is quite limited in comparison to the broader language Congress used in § 10(b) which prohibits fraud 'in connection with the purchase or sale of any security.'").

Commentators also share the view that the RICO language is narrower than 10b-5's language. *See, e.g., Glanz, supra* note 2, at 1525. ("Section 10(b) uses the phrase 'in connection with,' implying a broader array of activities than the more limited 'in' found in RICO."). However, Glanz contradicts himself on this issue:

The provision [RICO securities fraud] appears to suggest that almost all securities cases can be brought under RICO. Securities fraud is a general term and is used to characterize most violations of the securities laws. Hence, a broad reading of "fraud in the sale of securities" makes virtually every violation of the securities law a predicate act under RICO.

with,"<sup>147</sup> thereby ignoring congressional intent that RICO should be construed liberally. Moreover, the Supreme Court has noted that both Congress and courts use the terms "in" and "in connection with" interchangeably.<sup>148</sup> Therefore, Congress' use of "in" in the RICO securities fraud provision does not indicate that a narrow reading is appropriate.<sup>149</sup> Certainly, this difference in language between 10b-5 and RICO does not justify judicial limitation of a congressionally mandated cause of action.<sup>150</sup>

### B. *Comparisons of RICO and 10b-5*

Apart from inaccurately comparing the language of RICO and 10b-5, both the literal language and the 10b-5 factions neglect several fundamental differences between the two substantive provisions. First, 10b-5 is a judicially-implied private cause of action, while RICO securities fraud is an express private cause of action.<sup>151</sup> As the Supreme Court noted in *Blue Chip Stamps*, there are crucial differences between the two types of actions.<sup>152</sup> When Congress expressly legislates a cause of action, courts are bound to follow its mandate.<sup>153</sup>

Second, courts also misrepresent the policy arguments behind the 10b-5 purchaser-seller limitation. In interpreting 10b-5, the *Blue Chip*

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*Id.* at 1516 (footnote omitted). This contradiction illustrates the limited viability of the RICO 10b-5 language comparison argument.

147. Although many courts and commentators consider "in connection with" to be an "elastic nexus requirement," the fact remains that 10b-5 standing requirements prevent a large class of plaintiffs from seeking damages for fraud. Mathews, *RICO in Securities Litigation*, *supra* note 16, at 945. Thus, while "in connection with" may be interpreted broadly, 10b-5 standing is not interpreted broadly. Indeed, if "in" is more narrow in scope than "in connection with," RICO securities fraud is a virtual nullity. This would certainly contravene congressional intent. See MacIntosh, *supra* note 3, at 36 (admitting that "Congress intended radical surgery, through RICO, on a vexing problem").

148. *United States v. Naftalin*, 441 U.S. 768, 773 n.4 (1979).

149. *Id.*

150. See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 748-49 (1975) (reasoning that an expansive interpretation of a 10b-5 cause of action was acceptable because the action is judicially implied).

151. See *supra* notes 50-56 and accompanying text for a discussion of the 10b-5 private cause of action.

152. *Blue Chip Stamps*, 421 U.S. at 748. The Supreme Court noted that, when Congress expressly legislates a private cause of action, the judiciary must administer the law as enacted. However, a judicially implied private cause of action may be delimited in any manner by the courts until Congress addresses the question. *Id.* at 749.

153. *Id.* at 748.



*Stamps* Court balanced the concern for vexatious litigation with the concern for providing a remedy for defrauded plaintiffs.<sup>154</sup> The Court recognized that the purchaser-seller limitation “unreasonably prevents some deserving plaintiffs from recovering damages which have in fact been caused by violations of 10b-5.”<sup>155</sup> Indeed, the RICO securities fraud claims dismissed in the cases above exemplify the potential damages caused by “fraud in the sale of securities” not sufficiently “in connection with the purchase or sale of securities.”<sup>156</sup>

However, courts limiting RICO securities fraud neglect the *Blue Chip Stamps* balancing test and instead focus solely on fears of vexatious litigation.<sup>157</sup> These courts overlook the fact that Congress designed RICO to provide new weapons for defrauded plaintiffs.<sup>158</sup> Congress added the securities fraud offense to RICO after hearing testimony during congressional debate that fraud plagued the national se-

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154. *Id.* at 740-49.

155. *Id.* at 743.

156. *See, e.g., International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149, 150-51 (4th Cir. 1987) (involving a situation where the defendant allegedly defrauded the plaintiff out of “at least \$75,000”); *In re Par Pharmaceutical, Inc. Sec. Litig.*, 733 F. Supp. 668, 672-73 (S.D.N.Y. 1990) (defendants engaged in a massive bribery scheme in addition to lying to investors in shareholders’ reports and press releases); *Chief Consol. Mining Co. v. Sunshine Mining Co.*, 725 F. Supp. 1191, 1192-93 (D. Utah 1989) (defendant allegedly filed a false stock prospectus when offering for sale to the public 1,893,111 shares of stock at \$3.75 per share). The court dismissed each of these claims without examining the merits of the complaint.

Further, in *Securities Investor Protection Corp. v. Vigman*, 908 F.2d 1461 (9th Cir. 1990), the plaintiff claimed that the defendant defrauded investors of \$14 million and prompted the failure of two securities brokerage firms. Stephen Wermiel, *Top Court to Decide If Investors Can File RICO Lawsuit in Securities Fraud Cases*, WALL ST. J., Apr. 23, 1991, at A2. If the Supreme Court reverses *Vigman*, this fraud claim also will not be litigated.

157. *See, e.g., Zepkin*, 812 F.2d at 152-53 (failing to mention plaintiff’s injury or balancing test); *In re Par*, 733 F. Supp. at 682-84 (same); *Chief Consol. Mining Co.*, 725 F. Supp. at 1194 (same).

In *Gutman v. Howard Sav. Bank*, 748 F. Supp. 254, 265 n.8 (D.N.J. 1990), the court noted the *Zepkin* court’s important omission. In *Gutman*, the court held that New Jersey common law securities fraud does not contain the purchaser-seller limitation. *Id.* at 266. In so holding, the court noted that the *Zepkin* dictum neglects this *Blue Chip Stamps* balancing test:

[t]he dictum in *Zepkin* . . . is refuted by the Supreme Court’s own statement that the existence of common law claims without a purchase or sale requirement attenuates the injustice resulting from the imposition of the requirement in 10b-5 claims. *Id.* at 265 n.8 (citation omitted).

158. *See, e.g., MacIntosh, supra* note 3, at 9 n.11 (“Obviously the time has come for a frontal attack on the subversion of our economic system by organized criminal activities. That attack must begin, however, with the frank recognition that our present

curities exchanges.<sup>159</sup> Congress reasoned that RICO's securities fraud offense would increase a plaintiff's capabilities in fighting securities fraud.<sup>160</sup>

Finally, courts placing limitations on RICO securities fraud frustrate Congress' intent to augment RICO criminal enforcement with civil RICO actions.<sup>161</sup> Congress designed civil RICO specifically to compensate victims while deterring criminal activity.<sup>162</sup> Criminal RICO securities fraud actions are not burdened by the purchaser-seller limitation.<sup>163</sup> Similarly, courts should not circumvent congressional intent by limiting civil RICO securities fraud with the purchaser-seller limitation.<sup>164</sup>

Moreover, courts limiting RICO securities fraud disregard the fundamental difference between RICO and 10b-5. RICO is a remedial statute,<sup>165</sup> whereas 10b-5 was designed as a criminal statute. When Congress passed RICO, it envisioned an important role for civil liti-

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laws are inadequate to remove criminal influences from legitimate endeavor organizations." (quoting S. REP. NO. 617, 91st Cong., 1st Sess. 78-79 (1969)). *Id.*

*See also supra* note 2 and accompanying text for a discussion of the purposes of RICO.

159. *See supra* notes 42-48 and accompanying text for a discussion of the legislative history of RICO securities fraud.

160. *See United States v. Turkette*, 452 U.S. 576, 586 (1980) (stating that the purpose of RICO was to allow Congress to address a large and seemingly neglected problem because existing law, state and federal, was inadequate to address the problem).

161. *See supra* note 4 and accompanying text for a discussion of Congress' intent to supplement criminal prosecutions with civil actions in RICO.

162. G. Robert Blakey & Scott D. Cessar, *Equitable Relief Under Civil RICO: Reflections on Religious Technology Center v. Wollersheim: Will Civil RICO Be Effective Only Against White-Collar Crime?*, 62 NOTRE DAME L. REV. 526, 530 (1987) [hereinafter *Equitable Relief*] (stating that RICO's civil provisions create a private enforcement mechanism to compensate victims while deterring violators).

163. *See, e.g., Moss v. Morgan Stanley, Inc.*, 719 F.2d 5, 17 (2d Cir. 1983) (denying the plaintiff standing to sue under RICO securities fraud despite the defendant's prior criminal conviction for the same conduct); *Chief Consol. Mining Co. v. Sunshine Mining Co.*, 725 F. Supp. 1191, 1195 (D. Utah 1989) (citing *Moss* and companion criminal case, *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), for the proposition that criminal RICO prosecutions are immune from the purchaser-seller limitation).

Similarly, 10b-5 criminal prosecutions are immune from the purchaser-seller limitation. *See United States v. Naftalin*, 441 U.S. 768, 774 n.6 (1979) (stating that *Blue Chip Stamps* applies only to civil actions, not criminal actions).

164. *See, e.g., Chief Consol. Mining Co.*, 725 F. Supp. at 1194 (holding that the purchaser-seller requirement applies only to civil RICO actions and denying defrauded plaintiff relief).

165. RICO is primarily a remedial or civil statute. "[T]he criminal provisions are intended primarily as an adjunct to the civil provisions which I consider as the more

gants as "private attorneys general."<sup>166</sup> Indeed, civil RICO litigants utilize the same provisions as criminal prosecutors.<sup>167</sup> Conversely, Congress did not originally intend 10b-5 to contain a private cause of action.<sup>168</sup> Although criminal prosecutors utilize the express provisions of 10b-5, civil litigants access 10b-5 solely through judicial implication.<sup>169</sup>

Therefore, civil RICO securities fraud actions are not analogous to civil 10b-5 actions. Rather, civil RICO securities fraud is similar to criminal RICO and criminal 10b-5 securities fraud actions which both lack the purchaser-seller limitation.<sup>170</sup> To effectuate Congress' careful enforcement plan, RICO civil actions must garner the same freedom from judicial limitation as RICO criminal actions.<sup>171</sup>

### C. *Judicial Imposition of the 10b-5 Limitation: The Truth Behind the Rhetoric*

Courts articulate many reasons for limiting civil RICO securities fraud. In truth, however, these courts use the 10b-5 purchaser-seller limitation simply to shield corporations from RICO claims.<sup>172</sup> These

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important feature of the bill." 115 CONG. REC. 6993 (1969) (remarks of Sen. Roman L. Hruska regarding S. 1623).

166. Bridges, *supra* note 2, at 44. Civil litigants are crucial to combatting white collar crime because "federal investigative and prosecutorial resources for major financial institution fraud and embezzlement investigations and prosecutions [are] inadequate." *House Committee Report Criticized Justice, FBI Actions on Thrift Fraud, Banking Report (BNA) vol. 55, No. 21., at 854 (Nov. 26, 1990)*. "[L]ow wages among various federal enforcement agencies . . . contribute to rapid turnover . . . [causing] . . . serious delays and fewer major fraud cases." *Id.*

167. See *supra* notes 26-38 and accompanying text for a discussion of RICO's statutory language. See also Bridges, *supra* note 2, at 44 (stating that the combination of criminal and civil causes of action put prosecutors and plaintiffs in alliance).

168. *Blue Chip Stamps*, 421 U.S. at 729.

169. See *supra* notes 50-60 and accompanying text for a discussion of the judicial implication of the 10b-5 private cause of action.

170. See MacIntosh, *supra* note 3, at 68 (asserting that the soundest approach is to construe RICO alike in both the civil and criminal contexts).

171. See *supra* notes 161-69 and accompanying text for a proposal rejecting the purchaser-seller limitation and adopting RICO criminal securities fraud requirements for civil RICO actions.

172. See, e.g., *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 526 (1984) (Powell, J., dissenting) ("RICO . . . has been used more often against respected businesses with no ties to organized crime, than against the mobsters who were the clearly intended target of the statute."); *International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149, 153 (4th Cir. 1987) ("This circuit has been especially sensitive to the disruption of business activity by

courts succumb to the belief that white collar crime is somehow less culpable than other crime.<sup>173</sup> Moreover, these courts overlook the drastic effect white collar criminals have on society.<sup>174</sup>

By limiting RICO securities fraud, courts also seek to deter plaintiffs from abusing RICO.<sup>175</sup> However, RICO critics overstate the extent of RICO abuse.<sup>176</sup> When Congress enacted RICO, it balanced the concern of civil abuse with the concern for enhancing law enforcement capabilities.<sup>177</sup> Therefore, when courts depart from RICO's plain lan-

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lawsuits designed to poison the atmosphere with accusations of fraud . . ."); *Sedima, S.P.R.L. v. Imrex Co.*, 741 F.2d 482, 487 (2d Cir. 1984) (stating that civil RICO actions against "respected and legitimate enterprises" are extraordinary, if not outrageous); *Spencer Cos., Inc. v. Agency Rent-A-Car*, [1981-82 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,361, at 92,217 (D. Mass. Nov. 17, 1981) ("Among other things, a defendant may be exposed to pretrial discovery of every aspect of its business for a ten-year period.").

173. Euphemisms like 'commercial disputes,' 'commercial frauds,' 'garden variety frauds' and 'technical violations' . . . are sanitized phrases often used by 'legitimate businesses and individuals' to distinguish their frauds from the 'real' frauds perpetrated by 'real' crooks. Yet all willful fraudulent conduct has in common the elements of premeditation, planning, motivation, execution over time and injury to victims and commerce.

*Blakey & Cessar, supra* note 162, at 569-70 n.193 (quoting *Oversight on Civil RICO Suits: Hearings Before the Senate Judiciary Comm.*, 99th Cong., 1st Sess. 109-11 (1985) (testimony of Mr. Phillip A. Feign, spokesman for the North American Securities Administrators Association)).

174. *Id.* at 570 n.193 (white-collar crime defrauds Americans of about \$200 billion dollars a year). See also *U.S. Reports 18% Rise in '85 In White-Collar Convictions*; N.Y. TIMES, Sept. 29, 1987, at A24 (In 1985, charges for federal white collar crimes involved approximately \$800 million, robbery losses reported to the police amounted to slightly more than \$300 million).

175. *International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149, 153 (4th Cir. 1987) (stating that the danger of vexatious litigation is even greater in RICO treble damage suits); *Chief Consol. Mining Co. v. Sunshine Mining Co.*, 725 F. Supp. 1191, 1194 (D. Utah 1989) ("RICO plaintiffs should not be allowed . . . to [engage in] judicial system abuse.").

176. Kenneth F. McCallion, *RICO 'Abusive'? The Charge Is a Fraud; Congress Shouldn't Tamper with the Provision that Allows Consumers to Sue for Triple Damages*, NEWSDAY, Sept. 29, 1989, at 69 (finding that specific examples of RICO abuse are rare and that although over 1.9 million cases were filed in federal court from 1979 to 1988, a business coalition lobbying Congress to amend RICO could only produce 53 examples of alleged RICO "abuse"); *Blakey and Cessar, supra* note 162, at 534 n.29 (stating that out of approximately 275,000 suits filed each year, only 1,069 suits in 1986 were RICO cases, and 294 of these were terminated prior to trial).

177. See, e.g., *Sutliff, Inc. v. Donovan Cos.*, 727 F.2d 648, 654 (7th Cir. 1984) ("Congress deliberately cast the net of liability wide, being more concerned to avoid opening loopholes [for offenders] . . . than to avoid making garden-variety frauds actionable in federal treble damage proceedings — the price of eliminating of all possible

guage and place limitations on RICO, they substitute judicial lawmaking for legislative lawmaking.<sup>178</sup> Congress alone may limit RICO securities fraud if it deems the limitation prudent.<sup>179</sup> Congress' liberal application mandate is still in effect for civil RICO cases; courts are well-advised to follow it.

### CONCLUSION

Standing to sue for RICO securities fraud should be limited only by the requirements of criminal RICO securities fraud.<sup>180</sup> Consistent

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loopholes."); *Schacht v. Brown*, 711 F.2d 1343, 1354-55 (7th Cir.), cert. denied sub nom. *Arthur Andersen & Co. v. Schect*, 464 U.S. 100 (1983) ("Congress chose to provide civil remedies for an enormous variety of conduct, balancing the need to redress a broad social ill against the virtue of a tight, but possibly overly astringent, legislative draftsmanship.").

178. See *Carlson v. Green*, 446 U.S. 14, 53-54 (1980) (Rehnquist, C.J., dissenting). Chief Justice Rehnquist expressed his views on the judiciary's role in interpreting statutory language. Rehnquist stated:

I disagree . . . that . . . Congress must make some affirmative showing that it intends its action to provide such redress before this Court will deem Congress' action to be an adequate substitute for an inferred remedy. The requirement . . . subverts the policy making authority vested by the Constitution in the Legislative Branch. . . . [T]he Court's attempt to ascertain Congressional intention . . . demonstrates that the creation of [the purchaser-seller limitation] involves policy considerations that are more appropriately made by the Legislative rather than the Judicial Branch of our Government. . . . [W]hen Congress creates and defines the limits of a cause of action, it has taken into account competing considerations and struck what it considers to be an appropriate balance among them. . . . [I]t is wholly at odds with . . . the constitutional notion of separation of powers . . . for this Court to exercise free rein in fashioning additional rules for recovery of damages. . . .

*Id.* at 53-54 (footnote omitted).

179. Congress has attempted to amend RICO several times since 1985. In 1985, Representative Rick Boucher introduced a bill which would add a prior criminal conviction requirement to the civil provisions of RICO. Geoffrey F. Aronow, *In Defense of Sausage Reform: Legislative Changes to Civil RICO*, 65 NOTRE DAME L. REV. 964, 966 (1990). The House passed the bill, but the Senate defeated the measure by three votes. *Id.* at 966-67 n.21.

More recently, Senator Hughes of New Jersey introduced H.R. 1717, which requires judges to act as "gatekeepers" of civil RICO claims. Barbara Franklin, "*RICO Reform - Again*," N.Y.L.J., May 16, 1991, at 5. The bill requires courts to limit the use of civil RICO to proceedings "in the public interest" which deter only "egregious criminal conduct." *Id.* Further, the bill mandates that courts allow RICO claims only where "appropriate," given the magnitude of the injury. *Id.* Finally, the defendant must be a "major participant" in the activity causing the plaintiff's injury. *Id.* Given the hostility judges feel towards RICO, the "gatekeeper" reform bill would end the use of RICO in civil suits. *Id.* at 6.

180. A civil RICO plaintiff must first prove the elements of securities fraud. The

with § 1964(c), standing should be limited to plaintiffs injured "by reason of" a securities fraud violation.<sup>181</sup> This standing proposal maintains a narrow class of RICO securities fraud plaintiffs absent any judicially implied limitations.<sup>182</sup> More importantly, this standing proposal maximizes enforcement of the RICO securities fraud provision against white collar criminals worthy of RICO's bite.<sup>183</sup>

*Thomas W. Alvey, III\**

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plaintiff must prove that the defendant misstated or failed to disclose a material fact, that the defendant intended to deceive, and that the plaintiff reasonably relied on and was injured by the misstatement or omission. *Pelletier v. Zweifel*, 921 F.2d 1465, 1510 (11th Cir. 1991).

In addition, to prove a RICO violation, the plaintiff must establish that the defendant engaged in a "pattern of racketeering activity." 18 U.S.C. § 1962(c) (1988) and 18 U.S.C. § 1961(5) (1988). See *supra* notes 26-38 and accompanying text for the requirements of RICO.

Finally, pursuant to 18 U.S.C. § 1964(c) (1988), the plaintiff must prove that his injuries occurred "by reason of" the defendant's securities fraud violations. See *supra* note 128 and accompanying text for a discussion of the "by reason of" requirement as described in *Vigman*.

181. Adoption of the proposed standing requirement makes RICO securities fraud consistent with mail and wire fraud under § 1964(c) which grants standing to plaintiffs injured "by reason of" the mail or wire fraud violation. See *Pelletier*, 921 F.2d at 1506. See *supra* note 128 for a discussion of the "by reason of" limitation in RICO § 1964(c).

182. See *supra* note 180 for a discussion of the elements of criminal RICO securities fraud. These elements, coupled with the "by reason of" limitation in RICO, significantly narrow the class of plaintiffs which may bring a RICO securities fraud suit. See also *supra* notes 118-36 for a discussion of *Vigman's* limits on RICO securities fraud standing.

183. Even if the Supreme Court does not limit RICO securities fraud in *Vigman*, Congress may limit it. An impressive coalition of business groups, including accounting and securities organizations, has lobbied vigorously in Congress to amend RICO since 1985. The money and political power of this coalition virtually insures RICO's legislative limitation. It would be a cruel irony if these business groups acted "[t]o deprive consumers of an opportunity to recover multiple damages for fraud while . . . [business groups may still] sue for treble damages under the anti-trust laws . . ." Kenneth McCallion, *RICO Abusive? The Charge is a Fraud: Congress Shouldn't Tamper with the Provision that Allows Consumers to Sue for Triple Damages*, NEWSDAY, Sept. 20, 1989, at 69.

It would also be a cruel irony if so-called legitimate businesses such as accounting firms and securities firms decreased the remedies available to defrauded consumers, in light of the current savings and loan crises, insurance crises and insider trading crises. See, e.g., Herb Greenberg, *E.F. Hutton Admits Check Rigging Broker Netted \$1 Billion, Faces \$2 Million Fine*, CHI. TRIB., May 3, 1985, at C1 (E.F. Hutton & Co. pleaded guilty to 2,000 counts of intentionally rigging checks to defraud investors of over \$1 billion); *S&L Fraud Sentences Average 3.2 Years; Thrifts: The Justice Department Says Federal Cases in General Typically Draw 2.5 Year Terms*, LOS ANGELES TIMES, Sept. 4,

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1990, at D5 (president of First Maryland Savings and Loan embezzled at least \$60 million from his bank); WALL ST. J., May 6, 1991, at C9 (court orders Prudential Ins. Co. to pay \$1 million in punitive damages for maliciously and recklessly defrauding 74 year-old retired housewife); *Most People Wary of Executives: Poll*, CHI. TRIB., June 10, 1985 at C10 (survey shows that majority of Americans believe that corporate executives are dishonest and that white collar crime is frequent).

\* J.D. 1992, Washington University.





## **COMMENTS**

