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MEMORANDUM FOR THE AMERICAN BAR ASSOCIATION
CIVIL RICO TASK FORCE

Statement of Views of Charles L. Marinaccio, Commissioner, Securities and Exchange Commission

Introduction

I appreciate the invitation of the Task Force on Civil RICO to present my views on the civil treble damages provisions of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961, et seq.

Claims under RICO have become a frequent addition to complaints in private civil actions alleging securities fraud. This development has engendered tremendous controversy over the competing policies implicated by RICO's private right of action. As many commentators have noted, the threat of the negative publicity attendant to "racketeering" charges alone can provide the plaintiff with a powerful settlement tool regardless of the merits of the underlying legal claim.

Of particular concern is the fact that the potential availability of a statutory treble damage action under RICO threatens to expand significantly the carefully crafted

scheme of private rights of action, and express and implied remedies for securities law violations that the Congress and the courts have fashioned over the past 50 years. I do not believe that, in adopting RICO, the Congress intended to effect such a fundamental change in the operation of the federal securities laws, which should be made, if at all, only after complete and thorough examination of all relevant considerations.

Effect of RICO on Liability Under the Federal Securities Laws

Most treble damage RICO actions predicated on securities fraud have alleged violations of 18 U.S.C. § 1962(c), which makes it 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.

Because of the breadth of this prohibition, of RICO's private right of action, and of the statutory definitions provided such terms as "enterprise," most plaintiffs have had little difficulty in fashioning securities law claims into a colorable RICO claim. Although to my knowledge, no private RICO action predicated on securities fraud has yet gone to judgment, I believe that the availability of this expansive cause of

action may enable private plaintiffs to alter significantly the balance of rights and remedies established by the securities laws.

First, RICO appears to permit private plaintiffs to recover treble damages in cases where the Congress has expressly limited recovery under the securities laws to actual damages. For example, private recovery under the broad antifraud provisions of Section 10(b), and Rule 10b-5 promulgated thereunder, is limited by Section 28(a) of the Securities Exchange Act of 1934 to actual damages. 15 U.S.C. § 78bb(a). The apparent failure of the Congress to consider this inconsistency during its consideration of RICO stands in direct contrast to the careful and detailed consideration which the Congress afforded to the Insider Trading Sanctions Act of 1984, which authorizes the Commission to seek a civil penalty up to three times an insider trading defendant's profit or loss. In addressing this limited expansion of the remedies available under the Securities Exchange Act, the Congress carefully weighed the potential consequences; the impact of private RICO recovery on the federal securities laws private damage provisions received no such scrutiny.

Second, the breadth of RICO's provisions may even enable certain private plaintiffs to make out claims under RICO where they would not have standing to sue, or there is no

implied right of action, under the federal securities laws. Stated differently, RICO may permit private recovery for securities law violations which the Congress and the courts have determined should not give rise to private liability under the securities laws. This result is made even more anomalous by the fact that the RICO plaintiff may obtain treble recovery.

For example, in Blue Chips Stamps v. Manor Drug Stores, 412 U.S. 723 (1975), the Supreme Court held that only actual purchasers and sellers have standing to sue for violations of Rule 10b-5. However, it appears that a person who is fraudulently induced not to buy securities in a public offering might successfully argue that he was injured by the conduct of the affairs of an appropriately characterized "enterprise" through two or more acts of securities fraud, and thus make out a claim under RICO.

Similarly, in Piper v. Chris-Craft Industries, Inc., 430 U.S. 1 (1977), the Supreme Court held that an unsuccessful tender offeror in a contest for control of a corporation does not have an implied cause of action to sue for damages under Section 14(e) of the Securities Exchange Act, 15 U.S.C. § 78n(e). Nevertheless, it appears that, if some injury is alleged, such as an unfavorable change in the market price of the target corporation's stock, bidders could rely on the

same conduct to make out a cause of action for treble damages under RICO.

Finally, it appears that private plaintiffs who can allege similar injury may be able to recover under RICO for violations of the securities laws which the defendant committed against third parties -- notwithstanding the fact that such plaintiffs could not recover at all under the federal securities laws. For example, in Moss v. Morgan Stanley, 719 F.2d 5 (2d Cir. 1983), cert. denied, 104 S.Ct. 1280 (1984), the Second Circuit held that a defendant who purchased stock while in possession of misappropriated information was not liable in damages to the plaintiff (who unwittingly sold stock of the target company prior to public announcement of a tender offer) because the defendant owed no duty of disclosure to that plaintiff. In affirming dismissal of the securities law and RICO claims, however, the court appeared to assume that the plaintiff might have made out a sufficient claim under RICO if the complaint had alleged that the defendant's conduct, in breaching a duty to third parties, did otherwise constitute a violation of the securities laws.

Recommendation for Congressional Action

There is no evidence in the legislative history of RICO that the Congress anticipated that the adoption of that statute would bring about such a significant alteration of

the balance of the rights and remedies under the federal securities laws. In a recent decision, the United States Court of Appeals for the Second Circuit expressed similar concerns. See Sedima, S.P.R.L. v. Imrex Co., [Current] Fed. Sec. L. Rep. (CCH) ¶ 91,599 (2d Cir. July 25, 1984). After an exhaustive review of the statute's legislative history, the court concluded that the Congress intended to require proof of a prior criminal conviction for the predicate acts of racketeering in order to establish a private cause of action under RICO. Id.; accord Berg v. First American Bankshares, [Current] Fed. Sec. L. Rep. (CCH) ¶ 91,826 (D.D.C. Oct. 19, 1984).

I believe that this construction represents an appropriate resolution of the conflicts that private RICO actions predicated on securities fraud could otherwise create. */ The requirement of a prior criminal conviction introduces elements of prosecutorial discretion and a higher standard of proof that would operate to conform private litigation under RICO to cases involving the type of egregious conduct the Congress intended to reach. In this context, my concerns about any

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*/ An alternative resolution might be the requirement of a criminal indictment as a precondition to the private right of action.

remaining inconsistencies between private rights of action under RICO and the federal securities laws would be greatly alleviated.

Since the courts have been divided in their interpretation of the treble damage cause of action and there is no assurance that the United States Supreme Court will resolve the matter in the near future, I believe it would be desirable for the Congress to codify the Second Circuit's conclusion in an amendment to RICO.