Legal Opinion Letter

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SUPREME COURT SHOULD LIMIT CIVIL RICO CLAIMS

by
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The Supreme Court has agreed to hear a case which presents the court with an opportunity to limit civil claims based on RICO -- the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968. Originally intended to be a tool against organized crime and to protect legitimate businesses, RICO has become a weapon to harass and intimidate these very same legitimate businesses.

The issue before the Court in *Reves v. Ernst & Young*, No. 91-886, is whether the statute's phrase "to conduct or participate, directly or indirectly, in the conduct of [the] enterprise's affairs" in § 1962(c) requires proof that the defendant managed or operated the enterprise.

The facts of *Reves* highlight the way litigants attempt to turn ordinary commercial disputes into allegations that legitimate enterprises engaged in racketeering. In *Reves*, purchasers of demand notes from a cooperative filed suit against the cooperative's accountants, alleging securities fraud, breach of contract, and violation of RICO. Hired by the cooperative to audit its books, Ernst & Young (E&Y) utilized questionable auditing standards under which a gasohol plant the cooperative owned was valued far in excess of its actual value. Had its true value been used, the audit would have reported the cooperative as having negative net worth. Ernst & Young's audit reports to the cooperative's Board expressed "some doubt as to the recoverability of the investment" in the gasohol plant, but did not reveal that its audit method avoided a net worth problem. At two annual meetings, E & Y representatives spoke and fielded questions, but failed to tell the cooperative's members about the questionable valuation, or that write down of the gasohol plant's value to fair market value would wipe out the cooperative's net worth. Later, the cooperative filed bankruptcy, in part due to the financial problems of the gasohol plant.

The Eighth Circuit Court of Appeals upheld the district court's granting of E & Y's motion for summary judgment on the RICO claims[1], noting that:

> [E & Y's] involvement with the Co-op was limited to the audits, meetings with the Board of Directors to explain the audits, and presentations at the annual meetings. In the course of their involvement it is clear that [E & Y] committed a number of reprehensible acts, but these acts in

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> no way rise to the level of participation in the management or operation of the Co-op. *Id*. at 1324.

The Supreme Court should adopt the Eighth Circuit's "participation in the operation or management" standard. This construction of the statute is both faithful to the language of the statute and is an interpretation consistent with its goals. To adopt a broad interpretation of the participation requirement, as has been done in other circuits[2], would have three significant deleterious effects. First, it would vitiate congressional intent that the defendant's conduct or participation in the target enterprise be significant.

Second, it would legitimate the "federalization" of broad areas of state common law, such as contracts, fraud, and state securities law, disputes in which litigants and citizens are best served by having state courts resolve state law matters. Moreover, keeping such matters in state courts would give some relief to the presently heavily-burdened federal court dockets.

Third, it would "RICO-ize" broad areas of federal law governing relationships, such as labor and federal securities law, which was not within the enacting intent of Congress. As Justice Marshall pointed out, civil RICO is having the disastrous impact of "virtually eliminating decades of legislative and judicial development of private civil remedies under the federal securities laws." *Sedima v. Imrex Co.*, 473 U.S. 479 (1985).

The *Reves* case presents the Supreme Court with the perfect opportunity to halt the deluge of civil RICO claims[3], filed due to the statute's extremely potent dual incentive of automatic recovery of both treble damages and attorneys' fees. If the court fails to send a strong message that significant participation in the management or operation of the targeted enterprise is necessary for § 1962(c) civil RICO actions, more legitimate business enterprises will be labeled racketeers and extorted into settling such meritless claims, rather than face the ignominy of trying them. Moreover, continued unwarranted use of civil RICO will devastatingly alter the legal landscape, damaging decades of carefully crafted state and federal jurisprudence.

ENDNOTES

1. The district court also dismissed the breach of contract claims. The jury found that E&Y had committed both state and federal securities fraud, and awarded damages.

2. The Court of Appeals for the D.C. Circuit concisely analyzed the conflicting interpretations made by the circuits in *Yellow Bus Lines, Inc. v. Drivers, Chauffeurs & Helpers, Local Union 639,* 913 F.2d 948 (D.C. Cir. 1990).

3. Only nine civil RICO cases were reported prior to 1980. During the period November 1985 to June 1988, nearly 2,700 cases involved civil RICO were filed. "Civil RICO: The Runaway Treble Damage Bonanza," WLF LEGAL BACKGROUNDER, June 9, 1989.

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