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Less Corn and More Hell: The Application of RICO to Financial Institutions

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LESS CORN AND MORE HELL: THE APPLICATION OF RICO TO FINANCIAL INSTITUTIONS

Edward F. Mannino*

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I. THE HISTORICAL FRAMEWORK

"What you farmers need to do is raise less corn and more Hell!

We want the abolition of the National Banks, and we want the power to make loans direct from the Government. We want the accursed foreclosure system wiped out. We will stand by our homes and stay by our firesides by force if necessary, and we will not pay out debts to the loan-shark companies until the Government pays


(883)
WHEN Mary Elizabeth Lease spoke these words one hundred years ago at the First Meeting of the Populist Party, she drew upon an already long history of American antipathy toward bankers. Fueled by medieval prohibitions against usury, class conflict and fears of international conspiracies, Americans have often lashed out against bankers, particularly in times of economic depression. The classic confrontation between President Andrew Jackson and Philadelphia banker Nicholas Biddle over the rechartering of the Second Bank of the United States provides the paradigm. In vetoing the recharter, Jackson characterized the Bank's promoters as a "monied aristocracy" which sought "the advancement of the few at the expense of the many," and he emphasized the number of foreigners holding the Bank's stock as a danger to American economic independence.

In this century, the need for close governmental regulation of banking became and remains a popular theme, and fear of international banking conspiracies has surfaced often, usually laced with virulent doses of antisemitism. Anti-banker sentiment has also made its way into popular culture. Woody Guthrie defended the notorious bank robber Pretty Boy Floyd in his folk song of the same name by observing, "Some rob you with a six-gun, some with a fountain pen." More recently, Mick Jagger has sung of "gray-suited graftsters."

The American public has savored the fall of bankers from grace from early in our history. Three prominent Pennsylvania bankers are famous examples. Robert Morris, after whom a leading banking trade association was named because of his activities

1. Mary Elizabeth Lease, Speech at the First Meeting of the Populist Party, 1890, Topeka, Kansas, quoted in J.D. Hicks, The Populist Revolt 160 (1931).
2. Like many others who have attacked banks, Ms. Lease was a lawyer, one of the first women members of the Kansas Bar. Known for her "golden voice," she was the child of Irish political exiles. Born in Pennsylvania, she moved to Kansas in the 1870s, taught Catholic school, unsuccessfully tried farming, and became a noted speaker for Irish nationalism, women's suffrage and unions. See J.M. Burns, The Workshop of Democracy 185-86 (1985).
3. G.G. Van Deusen, The Jacksonian Era, 1828-1848, at 66-67 (1959). With increased foreign investment in American banks and with 25% of all domestic business loans now being extended by foreign banks, we may expect to hear more of the latter in the years to come.
5. Woody Guthrie, Pretty Boy Floyd.
as a financier of the American Revolution and founder of the first commercial bank in America, ended his career in debtor's prison. Even more dramatically, nearly a century apart, both Nicholas Biddle and Andrew Mellon were indicted at the end of their careers—Biddle for criminal conspiracy and Mellon for income tax evasion. Recent criminal indictments arising out of savings and loan and commercial bank failures continue this trend.

If, as Justice Holmes believed, "a page of history is worth a volume of logic," this tradition is one explanation for why banks are so often defendants in civil RICO suits. Indeed, RICO's continuity with this bank-bashing tradition of American history and culture was apparent in the first notable civil RICO suit against a bank, which was filed by a Georgia lawyer-borrower named Jackie Kleiner. Kleiner threatened to file similar actions, challenging banks' calculations of their prime rates, on a "bank-of-the-month-club" basis, and characterized the financial institution community as "banksters." His populist assault upon banks was reinforced when the Supreme Court rejected attempts to limit RICO's reach to organized crime, instead holding that:

Congress wanted to reach both 'legitimate' and 'illegitimate' enterprises. . . . The former enjoy neither an inherent incapacity for criminal activity nor immunity from its consequences. The fact that § 1964(c) is used against respected businesses allegedly engaged in a pattern of

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8. After Jackson's veto, the Second Bank of the United States was rechartered as the United States Bank of Pennsylvania. After that bank suffered a series of financial reversals, Biddle was indicted for criminal conspiracy, but acquitted. See _Van Deusen_, supra note 3 at 85.
10. See _Justice Launches New Attack on S & L Fraud in 'Acute' Areas_, 1 _BANK BAILOUT LITIGATION NEWS_ 3 (December 20, 1989), reporting on a Department of Justice initiative to prosecute criminal fraud affecting financial institutions. The article notes that a special task force in Dallas, Texas, has brought criminal charges against 57 defendants, convicting 46, including bank chairmen, presidents and vice presidents, with only two acquittals. Restitution awards exceeding $10 million were also imposed in these cases. _Id._
specifically identified criminal conduct is hardly a sufficient reason for assuming that the provision is being misconstrued.15

II. THE APPLICATION OF RICO TO FINANCIAL INSTITUTIONS

Financial institutions have been sued in a wide variety of civil actions under RICO.16 Typically, the plaintiffs have been either commercial borrowers17 or investors in failed enterprises which have been financed by the lender.18 These typical cases are by no means exhaustive, however. Other cases have been brought by plaintiffs as varied as home purchasers claiming knowledge of environmental hazards by a mortgage lender,19 subcontractors on housing projects financed by a lender,20 beneficiaries of trusts for which a bank acted as corporate trustee,21 discharged employees,22 and a patentholder claiming misappropriation of confidential information.23

III. 18 U.S.C. § 1962(c)

Most civil RICO suits against financial institutions have been filed under 18 U.S.C. § 1962(c), which provides in relevant part:

"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. . . ."

There are three key technical elements in a section 1962(c) action of particular interest to financial institution defendants, since their proper construction will often lead to the dismissal of

16. See generally E.F. MANNINO, LENDER LIABILITY AND BANKING LITIGATION § 4.02 (1989) [hereinafter MANNINO, LENDER LIABILITY].
22. See, e.g., Cullom v. Hibernia Nat'l Bank, 859 F.2d 1211 (5th Cir. 1988).
such defendants on initial motions directed to the sufficiency of the complaint or on motions for summary judgment. These are (1) the separate person and enterprise requirement, (2) the conduct requirement, and (3) the pattern requirement. The appropriate interpretation of each of these elements in a section 1962(c) case against a financial institution is discussed separately below.

A. The Person-Enterprise Requirement

As the Supreme Court has noted, "[T]he major purpose of [RICO] is to address the infiltration of legitimate business by organized crime." For this reason, section 1962(c) speaks of two entities—an "enterprise" which represents the infiltrated entity, and a "person" which embodies the infiltrator. Virtually every court which has considered the issue has concluded that section 1962(c) requires two separate entities to satisfy these discrete roles, and that the same entity cannot serve simultaneously as both person and enterprise. In addition, most courts have held that the enterprise cannot be liable for damages for a violation of section 1962(c) since the statute sculpts it as a victim of racketeering activity. As the Third Circuit explained in *B.F. Hirsch v. Enright Refining Co.*:

One of the Congressional purposes in enacting RICO was to prevent the takeover of legitimate businesses by criminals and corrupt organizations. . . . It is in keeping with that Congressional scheme to orient section 1962(c) toward punishing the infiltrating criminals rather than the legitimate corporation which might be an innocent victim of the racketeering activity in some

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24. For a discussion of other elements of § 1962 and § 1964, such as proximate cause, standing, and compensable injury, see MANNINO, LENDER LIABILITY, supra note 16, § 4.03 [5].

25. The discussion of this element below is limited to actions brought under § 1962(c), since several courts have interpreted other subsections of § 1962 not to impose such a requirement of separate entities. See, e.g., PetroTech, Inc. v. Western Co., 824 F.2d 1349, 1360-61 (3d Cir. 1987).


28. 751 F.2d 628 (3d Cir. 1984).
Requiring separate entities to serve as person and enterprise, and holding only the person liable for damages, has created problems for RICO plaintiffs suing banks, particularly where these plaintiffs are borrowers. In such cases, the bank itself is the only entity dealing with the plaintiff, and a second entity must be found to serve as the enterprise. Three approaches to this problem have emerged, with mixed results.

1. Affiliated Corporations

An early approach to solving the second entity problem was to name the bank as the person conducting the affairs of its bank holding company parent, which served as the enterprise. This approach was approved by the Seventh Circuit in *Haroco Inc. v. American National Bank & Trust Co.*, an early borrower case. There, the court concluded that it was “virtually self-evident that a subsidiary acts on behalf of, and thus conducts the affairs of, its parent corporation.” As with many self-evident propositions, however, this conclusion merely begs the question, and is analytically incorrect where there is no substantive interaction of the two entities.

Section 1962(c) contemplates an interaction of entities, with the responsible person influencing the entity by conducting its affairs through a pattern of racketeering activity. As such, the mere fortuitous presence of a parent-subsidiary relationship, without more, should not be sufficient to impose liability upon a bank for a violation of section 1962(c) without a substantive showing of such actual conduct, with the affairs of one entity being influenced by the other.

29. *Id.* at 633-34 (citations omitted); see also *Bennett*, 770 F.2d at 315 (“[R]equiring a distinction between the enterprise and the person comports with legislative intent and policy. Such a distinction focuses the section on the culpable party and recognizes that the enterprise itself is often a passive instrument or victim of the racketeering activity.”).

30. *In cases where investors in a failed enterprise financed by the bank are the plaintiffs, however, no such technical problem arises, since the failed entity can serve as the enterprise, and the financing bank as the person.*


33. See *Mannino, Lender Liability*, *supra* note 16, § 4.03 [2][b].

34. For a discussion of the type and quantum of activity needed to satisfy the conduct requirement, see *infra* notes 54-65 and accompanying text. See also *NCNB Nat’l Bank*, *supra* note 32.

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29. *Id.* at 633-34 (citations omitted); see also *Bennett*, 770 F.2d at 315 (“[R]equiring a distinction between the enterprise and the person comports with legislative intent and policy. Such a distinction focuses the section on the culpable party and recognizes that the enterprise itself is often a passive instrument or victim of the racketeering activity.”).

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34. For a discussion of the type and quantum of activity needed to satisfy the conduct requirement, see *infra* notes 54-65 and accompanying text. See also *NCNB Nat’l Bank*, *supra* note 32.
A more analytically sound resolution of this issue was reached by the Fifth Circuit after Haroco. In Atkinson v. Anadarko Bank and Trust Co., the court rejected an attempt by borrower plaintiffs to separate a bank person from an association in fact enterprise composed of the bank, its holding company parent and three employees. In upholding the setting aside of a multimillion dollar jury verdict, the appeals court reasoned:

The record here contains no evidence that the bank, its holding company, and the three employees were associated in any manner apart from the activities of the bank. Plaintiffs wholly failed to establish the existence of any entity separate and apart from the bank. In this case, the alleged racketeering activity forming the predicate of the RICO charge was mail fraud—the mailing of false statements requesting payment of interest in excess of the agreed amount. The mailing of loan statements was an activity of the bank. There is no evidence of any other activity on the part of the alleged enterprise.

Even though there was some action by the holding company in Anadarko, since it purchased shares of plaintiffs' notes from the bank, this was found insufficient since the banking activity in question in the suit was that of the bank alone, and the holding company had no separate relevant activity.

A similar approach was followed in United States Auto Finance Co. v. Union Federal Savings & Loan, a case brought by defrauded investors in a used car business financed by a bank. Plaintiffs claimed that the enterprise consisted of the bank, two of its employees and the third party who devised the fraudulent scheme. In dismissing a section 1962(c) count against the bank, the district court concluded that "[e]ven if Union Federal, through its board of directors or through its employee . . . actively participated in the scheme to defraud plaintiffs, it cannot be held liable under section 1962(c), because the scheme was accomplished only by using Union Federal's banking services, and Union Federal cannot be both a person and the RICO enterprise."
The line of demarcation between person and enterprise drawn by these cases requires more than separate formal entities to impose section 1962(c) liability upon a bank. The factor which must be added to the separate entities for liability under section 1962(c) is substantively relevant activity by both entities, with an interaction between the two. An example may be helpful on this arcane, but important, point. Assume a bank holding corporation causes a newly acquired bank subsidiary to call all loans through mailed notices declaring defaults contrary to the terms of the written loan documentation where the borrowers are farmers, on the basis that farm loans are poor risks. Here, a person (the holding company) causes an enterprise (the newly acquired bank) to conduct its affairs through a pattern of racketeering activity (mail fraud), with the person dictating a policy which is then implemented by the enterprise. Imposing liability upon the bank holding company in such circumstances comports fully with the RICO infiltration model and is thus appropriate under section 1962(c). 39

2. Vicarious Liability

A second approach to the separate entities problem is to name the bank officers on the affected loan or workout as the persons conducting the affairs of the bank enterprise, and then to hold the bank in turn civilly responsible for the actions of those officers under theories of agency or respondeat superior. While this approach received some early support at the district court level, 40 it has correctly been rejected by every federal appeals court which has considered the issue. 41 The simple and most direct answer to why theories of vicarious liability are inappropriate could have designated the used car business as the enterprise, with the bank as the person conducting its affairs to defraud plaintiffs. For a discussion of the conduct requirement, see infra notes 53-70 and accompanying text.


is supplied by the statute itself, which requires two distinct entities, and declares "unlawful" only the actions of the person who conducts the affairs of a separate enterprise through a pattern of racketeering activity. As one court noted:

It makes little sense to require that the "enterprise" and the "person" be distinct, but then to impute liability from the "person" to the "enterprise" as a matter of course when the "enterprise" employs the "person." Such a result is simply inconsistent with the framework of the statute and the intent of Congress.\textsuperscript{42}

Given the unanimity of appellate authority concerning the unavailability of vicarious liability under section 1962(c), it is unlikely that this theory will be pursued in the future.\textsuperscript{43}

3. \textit{Associations in Fact}

A third approach to the separate entities problem is to sue the bank as a person conducting the affairs of an association in fact enterprise composed of the bank and bank officers or any available third parties. This approach has met with mixed results, with bank defendants raising two principal objections to the approach.

The first objection is based upon the statutory definition of an enterprise, which provides that 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."\textsuperscript{44} Defendants have argued that this definition limits an association in fact enterprise to entities composed solely of individuals. While this argument has a statutory basis, it has proved generally unpersuasive on two grounds. First, most courts stress that the definitional section is only "illustrative, not exhaustive," given its use of the word "includes."\textsuperscript{45} Second, the


\textsuperscript{43} Since most of the cases on this point have treated the enterprise as a victim, they do not conclusively bar the availability of vicarious liability where the enterprise participates in, profits from, or authorizes the person's acts. Even in such cases, however, the statutory language bars imposing vicarious liability on the person. See \textit{Mannino}, \textit{Lender Liability}, supra note 16, \textsection 4.05 [2][c].


liberal construction clause of RICO\(^46\) has been invoked to resolve this point in favor of the plaintiffs on policy grounds.\(^47\) As one court observed, ""[W]e think it unwise policy to permit individuals to escape the reach of RICO through the simple artifice of incorporating."\(^48\)

Banks have proved more successful in their second argument against use of association in fact enterprises which include the bank as a member. This argument is based upon the requirement that an enterprise must be a "continuing unit" with an "ascertainable structure distinct from the pattern of racketeering activity."\(^49\) As we saw in our prior discussion of the Anadarko Bank and United States Auto Finance Co. cases, this requirement has resulted in dismissals of RICO cases for failure to demonstrate an ongoing enterprise separate and apart from the bank itself.\(^50\) As such, where the substantive conduct at issue is that of the bank alone, attempting to sue the bank under section 1962(c) as a person conducting an association in fact enterprise including itself is likely to fail.

By contrast, Atlas Pile Driving Co. v. DiCon Financial Co.,\(^51\) which upheld a RICO treble damage jury verdict against a mortgage lender, shows the proper use of an association in fact enterprise which includes a bank. There, a mortgage lender and its

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\(^46\). Pub. L. No. 91-452, § 904(a), 84 Stat. 947 (1970) (providing that RICO "shall be liberally construed to effectuate its remedial purposes").

\(^47\). For cases deciding in favor of plaintiffs on policy grounds, see supra note 45.

\(^48\). Atlas Pile Driving Co., 886 F.2d at 995 n.7.


\(^50\). For a discussion of the "enterprise" element in Anadarko Bank and United States Auto Finance Co., see supra notes 35-38 and accompanying text.

affiliated real estate development corporation were sued as persons conducting the affairs of an association in fact enterprise composed of themselves and other affiliated entities involved in the construction and sale of two residential housing projects. Subcontractors on those projects sued the mortgage lender for participating in a fraudulent scheme to defraud the subcontractors of payment for their materials and labor. While the court did not adequately explain its reasoning in treating this association in fact as a proper enterprise, the result reached is sound, because the enterprise had a functioning existence separate and apart from the mortgage lender and its activities. For the scheme to work, each of the separate entities which composed the association in fact had to perform an assigned part. Thus, the mortgage lender provided funds for developing the property; the real estate development firm hired subcontractors and falsely promised them payment, and, at the same time it paid an affiliated subcontractor who performed carpentry work and was also a member of the association in fact enterprise.

B. The Conduct Requirement

Section 1962(c) declares it unlawful for a person "to conduct or to participate, directly or indirectly in the conduct of [an] enterprise's affairs through a pattern of racketeering activity." "Conduct" is not defined in the RICO statute, and the level of activity it requires is by no means clear from the relatively sparse civil RICO case law on point, which has divided into two general camps. The first approach requires that the person have some managerial participation in the enterprise, while the second requires only a nexus between the pattern of racketeering activity and the affairs of the enterprise.

The issue arises in civil RICO cases against banks in two principal contexts. In borrower or other cases where the bank deals directly with the plaintiff, the conduct requirement will typically pose little problem to plaintiffs, for the bank's own affairs will be at issue. By contrast, in the second major category of cases involving banks as section 1962(c) defendants—those involving in-

52. "The methodology employed was consistent in that DiCon loaned funds to an undercapitalized insider borrower, DiCon foreclosed when the borrower failed to pay, the subcontractors' liens were subordinate to DiCon's mortgage, and Conry, DiCon and LMH thus gained the value of the subcontractors' work without remunerating them." Atlas Pile Driving Co., 886 F.2d at 994.

53. See generally MANNINO, LENDER LIABILITY, supra note 16, § 4.03 [4].

54. In such cases, as we have seen, a more difficult obstacle will be satisfy-
vestors in a failed enterprise financed by the bank—the conduct requirement, on its face, raises an attractive defense for lenders, since lenders do not in any popular sense of the term “conduct” the affairs of their borrowers.55

1. The Management Approach

Following the common meaning of the term, the Eighth Circuit en banc in Bennett v. Berg,56 held that “[a] defendant’s participation must be in the conduct of the affairs of a RICO enterprise, which ordinarily will require some participation in the operation or management of the enterprise itself.”57 This same managerial approach was urged by defendants and amici upon the Supreme Court in American National Bank & Trust Co. v. Haroco, Inc.,58 but the Court declined to reach the conduct issue, holding that it had not been raised properly.59

Since Haroco, a number of other courts have adopted the managerial approach, or some variant, focusing upon the positions held by the RICO person defendant, and the policy-shaping

55. WEBSTER’S NINTH NEW COLLEGIATE DICTIONARY 274 (1987) tells us that “conduct,” in a business context, means “to direct or take part in the operation or management of . . . a business.” It further explains that conduct “implies taking responsibility for the acts and achievements of a group.”

56. 710 F.2d 1361 (8th Cir.) (en banc), cert. denied, 464 U.S. 1008 (1983).

57. Id. at 1364.


59. Id. at 608. The amicus brief of the American Bankers Association argued:

If liability is to be predicated upon the interrelationship of the bank and bank holding company, a RICO plaintiff must be able to allege some meaningful domination or control by one of those entities (the “person”) over the affairs of the other (the “enterprise”) in such a way as to cause the other to commit illegal activity as a matter of corporate policy dictated by the defendant. A mere relationship or association, without more, is a neutral fact under RICO, which requires the active “conduct” by the “person” of the affairs of the “enterprise”. Brief of the American Bankers Association as Amicus Curiae at 18, American Nat’l Bank & Trust Co. v. Haroco, Inc. 473 U.S. 606 (1985) (No. 84-822).
powers inherent therein. In Lipin Enterprises, Inc. v. Lee, which followed a managerial approach, several bank defendants were dismissed from a section 1962(c) action, inter alia, because there was no clear showing that they "conducted or participated in the direction or management of the companies' affairs," even though the plaintiff alleged that it was induced, pursuant to a scheme in which the banks participated, to purchase stock in two companies at an inflated price to enable the companies to repay a substantial indebtedness to the banks.

2. The Nexus Approach

A second line of cases adopts a more liberal standard, under which a defendant is considered to conduct the affairs of a RICO enterprise if it performs acts "necessary or helpful to the operation of the enterprise." In Bank of America National Trust & Savings Association v. Touche Ross & Co., this standard was utilized to hold that outside auditors conducted the affairs of their clients within the meaning of section 1962(c).

Courts following the nexus approach emphasize the broad remedial purposes underlying RICO, and the language of section 1962(c), which uses the words "participate, directly or indirectly" as well as the word "conduct" in describing the prohibited action. Following this standard, one district court has held, on a


61. 625 F. Supp. 1098 (N.D. Ill. 1985), aff'd on other grounds, 803 F.2d 322 (7th Cir. 1986).

62. 625 F. Supp. at 1100. On these facts, a better case could have been made for aiding and abetting or conspiracy liability for the banks. See MANNINO, LENDER LIABILITY, supra note 16, §§ 7.01-7.02. For the use of an aiding and abetting theory against banks under § 1962(c), see Rodriguez, 727 F. Supp. at 773-74.


64. 782 F.2d 966 (11th Cir. 1986).

65. Id. at 970.

motion to dismiss, that a bank could be considered to have indirectly participated in the conduct of the affairs of a limited partnership it financed by participating in a loan to the partnership, and taking the investor plaintiffs' notes as security for that loan. 67

The nexus approach to the conduct issue is unsound for two reasons. As a matter of statutory interpretation, it elevates the modifying words "participate" and "indirectly" to a prominence which overshadows the principal statutory word—"conduct"—which section 1962(c) uses twice, once as a verb identifying the prohibited action, and the second time as a noun describing the prohibited action. "Conduct" means directing or taking part in the operation or management of a business, 68 and provides the standard by which courts should be guided in interpreting section 1962(c).

There is a second, equally important, reason for courts to adopt the managerial approach to the conduct issue. That reason is to construe RICO in harmony with the many other statutory provisions and common law theories under which lenders have been held liable for controlling the affairs of borrowers. 69 Under each of those theories, ranging from statutory liabilities for payment of withholding taxes and for federal securities and environmental law violations, to common law liability under the instrumentality and equitable subordination doctrines, courts have focused on whether lenders have intruded into the day-to-day operations of a borrower's business. Relevant factors that courts consider in determining whether to impose such control liabilities include whether the lender engaged in any of the following activities:

1) Determining which creditors should be paid, or which checks to honor;
2) Collecting funds owed to the borrower directly from third parties, and paying the borrower's bills;
3) Vetoing specific transactions, including business expansion plans and hiring proposals;


68. For a definition of "conduct," see supra note 55.
69. See generally Mannino, Lender Liability, supra note 16, §§ 6.01-.06.
4) Terminating top management or a majority of employees, or drastically cutting salaries;
5) Developing detailed long-term business plans, or sales, credit, and inventory policies for the borrower;
6) Selecting specific directors or management consultants for the borrower;
7) Voting pledged stock;
8) Requiring prior approval of day-to-day business decisions;
9) Assuming control over, or possession of, a borrower's property or business records; and
10) Holding undated resignations.70

Courts faced with deciding whether to impose section 1962 (c) liability upon a bank for "conducting" the affairs of a borrower should utilize the managerial test as the controlling standard, and use these benchmarks to evolve a consistent and statutorily sound approach.

C. The Pattern Requirement

1. The Evolving Case Law

In the early years of civil RICO litigation, little attention was paid by litigants or the courts to RICO's requirement that plaintiffs prove that the defendant conducted the affairs of an enterprise through a pattern of racketeering activity. Instead, most courts assumed that the pattern requirement was satisfied if the defendant committed two or more predicate acts within the ten year period specified in the statute.71 In a provocative footnote in its majority opinion in Sedima, S.P.R.L. v. Imrex Co.,72 the Supreme Court questioned such an interpretation in dictum, and ended the opinion by chiding both the lower courts and Congress for failing “to develop a meaningful concept of ‘pattern.’”73 The Court suggested that RICO was not aimed at sporadic or isolated acts, and implied that the pattern requirement was satisfied only where

70. This list is taken from Mannino, Lender Liability, supra note 16, § 6.07[1], at 6-36.
71. 18 U.S.C. § 1961(5) (1988), defining “pattern,” inter alia, as “requiring at least two acts of racketeering activity.” For early interpretations of this requirement, see Mannino, Lender Liability, supra note 16, § 4.03[3][a], at 4-24.
73. Id. at 500.
the predicate acts possessed "continuity plus relationship." 74

The lower federal courts paid close attention to the Supreme Court's challenge in Sedima to develop a "meaningful" definition of pattern. Over the course of the next four years, literally hundreds of opinions addressed the issue, culminating in what Justice Scalia of the Supreme Court characterized as "the widest and most persistent circuit split on an issue of federal law in recent memory." 75 Three general approaches emerged, along with minor variations of each. At one extreme, some courts viewed the pattern requirement as mandating proof only of two related predicate acts. Courts at the other extreme required proof of separate criminal episodes. A third group took a more nuanced approach, examining such factors as the number of participants and people affected, the duration or time span of the alleged predicate acts, the number and type of acts, the number and separateness of episodes, the number of purposes underlying the acts, and the threat of continuing criminal activity. 76

In H.J., Inc. v. Northwestern Bell Telephone Co., 77 the Supreme Court reexamined the pattern requirement in light of this split in circuits. With four justices inviting constitutional challenges to the statute, the Supreme Court rejected both extreme approaches, and declined to adopt the third.

The plaintiffs in H.J. were telephone customers who alleged that the telephone company had engaged in a pattern of corrupt behavior, including making cash payments and supplying gratuities to state utility commissioners, to obtain approval of excessive rates over a six year period. While the Court agreed that this was sufficient pleading of a pattern of racketeering activity, it gave only broad benchmarks as guides for construing that requirement in the future.

Emphasizing repeatedly that RICO was a "broad" and "flexible" statute, and rejecting a "narrow" or "pinched" construction tied to an "organized-crime-type perpetrator," the majority reaffirmed its Sedima dictum that the twin keys to defining the pattern requirement were the concepts of "continuity" and "relation-

74. Id. at 496 n.14.
76. The three approaches, and the cases discussing them, are discussed at length in Mannino, Lender Liability, supra note 16, § 4.03[3][b], at 4-25 to 4-30.
As in *Sedima*, the majority opinion characterized the relationship component as requiring "criminal acts that have the same or similar purposes, results, participants, victims, or methods of commission, or otherwise are interrelated by distinguishing characteristics and are not isolated events." 79

On the more difficult issue of what the continuity component required, the majority chose to paint in broad strokes, announcing that continuity is "centrally a temporal concept" and that "long-term criminal conduct" was the evil at which RICO was directed. 80 The majority thus concluded that "[p]redicate acts extending over a few weeks or months and threatening no future criminal conduct do not satisfy this requirement." 81

On the question of how to determine whether particular predicate acts raised the threat of "future criminal conduct," the majority concluded that such a determination "depends on the specific facts of each case," but noted that one way to prove such a threat was by demonstrating that "the predicate acts or offenses are part of an ongoing entity's regular way of doing business." 82

2. *Application of the H.J. Pattern Analysis to Section 1962(c) Actions Against Financial Institutions*

While broad and nonspecific, the *H.J.* approach to the pattern requirement should prove helpful in damming the flood of section 1962(c) actions against financial institutions. Once again, as with the person-enterprise and conduct requirements, the impact will vary depending upon whether the plaintiff is a borrower or a third party. These two general types of litigation are analyzed separately below.

a. **Borrower Litigation**

Litigation brought by borrowers will most easily satisfy the pattern requirement after *H.J.* where it is predicated upon some regular practice of the bank in its dealings with borrowers. As such, cases challenging the manner in which a bank computes its

78. *Id.* at 2900.
79. *Id.* at 2901 (quoting 18 U.S.C. § 3575(e) (1982)).
80. *Id.* at 2902.
81. *Id.*
82. *Id.*
interest rates$^{83}$ or credits funds deposited$^{84}$ will be the easiest cases for borrower plaintiffs on this point. In the absence of an attack upon a general practice of the bank, however, it will become more difficult for borrowers to prove a pattern under section 1962(c), particularly where borrower-specific behavior by loan officers on a particular credit is involved.

Some such cases will be dismissed on the pleadings. For example, making threats over a period of days that particular borrowers will be jailed for non-payment of their loans does not constitute a pattern, in the absence of evidence that this is a regular practice of the lender.$^{85}$ Where, by contrast, behavior over a period of months is involved, courts will need to sort through the allegations more closely. Where the activity involved has ended before the suit is brought, plaintiffs' burden will often be difficult. Thus, where borrowers claimed that a lender breached a commitment to provide interim financing for a housing development and devised a scheme to take over the development for its own benefit, a court applying the H.J. standard granted summary judgment for the lender, concluding that "one year's worth of predicate acts" which concluded before suit was commenced did not establish "a sufficient threat of continuity."$^{86}$ While such a ruling may have stretched H.J. beyond its intended limits, it demonstrates that even behavior extending almost a year may not be sufficient to constitute a pattern, where it is not done as part of a lender's regular practice, and affects only a single borrower on a particular loan.

Cases involving multiple predicate acts over a few months may also be dismissed on summary judgment where no regular practice of the lender is implicated. For example, fraudulent


$^{84}$ See, e.g., Mid-State Fertilizer Co. v. Exchange Nat'l Bank, 877 F.2d 1333 (7th Cir. 1989).

$^{85}$ Edwards v. First Nat'l Bank, 872 F.2d 347, 352 (10th Cir. 1989) (threats to three borrowers on two consecutive days that they "would all go to jail" insufficient to establish a pattern pre-H.J.); see also Graue Mill Dev. Corp. v. Colonial Bank & Trust Co., No. 88 C 2584 (N.D. Ill. Jan. 4, 1990) (1990 WL 6823) at *8 n.2 (alleged misrepresentations to one borrower would not constitute pattern since only "one victim and one scheme" involved).

$^{86}$ Myers v. First City Bank, No. 86-3393 (E.D. La. July 21, 1989) (LEXIS, Genfed library, Dist file) at *10. There, the court also found a post-suit letter from the lender indicating that it had liquidated some collateral insufficient to establish a threat of continuity.
pledging of assets, fraudulent subordination of a lien and seizure of the fraudulently pledged assets were found insufficient to establish a pattern of racketeering activity under the H.J. standard because they involved “only at most a three month period of time, a single victim and a single injury.”

While H.J. will thus give lenders considerable comfort in cases not involving regular practices of the bank where the conduct in question lasted less than one year and is completed before any suit is commenced, it will not be of much assistance at the pleadings stage in the case of a troubled loan which extends over a period of years and the bank’s continuing actions during that extended period are challenged. Thus, one pre-H.J. case found the pattern element satisfied in a case claiming that a coal broker’s contracts to supply two utilities were seized by its lender for breach of a workout agreement, and that the lender converted the broker’s funds to its account. There, the court found sufficient allegation of a pattern in multiple alleged acts of wire and mail fraud over a period of four years, with four victims, and a number of perpetrators.

b. Third Party Litigation

Third parties, particularly investors in failed enterprises financed by a bank, will often have a difficult time satisfying the pattern requirement after H.J. It will ordinarily be impossible, consistent with ethical and legal responsibilities, to allege that a lender conducted its borrower’s affairs through a pattern of racketeering activity, since absent the exercise of sufficient control over the affairs of the borrower of a type consistent with the level required by statutory and common law theories of control liability, a lender’s usual activities will be limited to making and mon-


90. For a discussion of statutory and common law theories of control liability, see supra notes 67-68 and accompanying text.
itoring a particular loan. Even where such activities extend over a prolonged period of years, they are likely to be isolated and sporadic, and typically will be difficult to link, in any meaningful sense of proximate causation, to the harm suffered by an investor plaintiff. As such, investor plaintiffs will have considerable difficulty pleading and proving the type of "long-term criminal conduct" required by H.J., either as a matter of regular ways of doing business by a lender, or relevant long-term activity linked to the plaintiff's injury.

Other third party plaintiffs may more easily be able to squeeze a lender's activities within the H.J. pattern framework. Atlas Pile Driving Co. v. DiCon Financial Co. again supplies a helpful example. In that case, although the lender's activities were limited to the financing of only two housing projects, the court found this sufficient to constitute a pattern of racketeering activity harming the defrauded subcontractor plaintiffs because the lender's acts of mail fraud, in mailing foreclosure notices which resulted in barring the subcontractors' liens, extended over a period of three years, harmed a number of different subcontractors, affected two different projects and "involved a complex series of activities indicating continuity, such as the numerous corporate entities created . . . and the working and financing arrangements employed."

IV. Conclusion

As historically unpopular entities, financial institutions have been disproportionately named as RICO defendants in civil actions commenced under 18 U.S.C. § 1962(c). Such suits are, however, peculiarly vulnerable to a number of technical challenges by such defendants. In most borrower suits, plaintiffs will be unable to plead or prove an ongoing enterprise separate and distinct from the bank itself. In third party suits, the conduct requirement, properly construed to require some managerial control over a business financed by the lender, will usually prove an


93. Id. at 994-95. A similar close relationship among the developers and their financiers led to a finding of pattern and a potential aiding and abetting claim against the financiers in Rodriguez v. Banco Central. See 727 F. Supp. 759, 772-75 (D.P.R. 1989).
insurmountable hurdle. Finally, the pattern requirement after *H.J.* will cut down further on suits against lenders by both borrowers and third parties where no regular practice of the bank is challenged. In combination, these three points should go far toward diminishing that portion of a financial institution’s legal budget devoted to defending RICO lawsuits.94

94. Other defenses not discussed in this article, including lack of proximate cause between the activities of the lender and the harm suffered by the plaintiff; release, waiver and estoppel; and absence of scienter should also be explored by financial institution defendants in civil RICO suits. See, e.g., Mannino, *supra* note 13, at 211-12 (release, waiver and estoppel); MANNINO, LENDER LIABILITY, *supra* note 16, § 4.03[5][b] (proximate cause); § 4.04[4] (release, waiver and estoppel); § 4.07[4] at 4-58 to 4-59 (scienter in mail fraud cases).