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Because all practitioners who offer comments on RICO are influenced by their own experience, let me begin by stating my own. I bring the perspective of a defense lawyer who has represented professionals in civil litigation under RICO. These civil cases have no criminal counterparts; the civil RICO suits have been filed against individuals not threatened with criminal prosecution despite extensive investigation by grand juries or government enforcement agencies, such as the United States Securities and Exchange Commission. The cases typically arise in a commercial setting in which there has been a business failure, and the civil RICO suits are filed against a number of defendants who allegedly "contributed" in some way to that failure.[1]

The "professionals" to whom I refer in the title of this paper include lawyers and accountants, but observations apply equally to a broader, generic class of people who have become RICO defendants in such situations. These are people whose services are a necessary or facilitating ingredient of a business transaction of some type, but who lack a direct stake in the success of the transaction. Besides lawyers and accountants, lenders, appraisers, engineers and other "experts" fall into this class.

When I participate in continuing legal education programs on RICO, I usually concentrate on legal issues of particular interest to professionals who are civil RICO defendants. These issues are often litigated at the motion to dismiss phase of a civil RICO action and include:

* whether Federal Rule of Civil Procedure 9(b) requires factual substantiation of allegations of fraud against a professional;
* whether a professional can be said to be "conducting the affairs" of an entity that receives the professional's services, within the meaning of 18 U.S.C. § 1962(c); and
* whether a professional is subject to respondeat superior liability under RICO and, if so, under what standards.

This conference, however, provides an opportunity to go beyond these nuts-and-bolts topics. We have an opportunity to look critically at RICO and ask more fundamental questions. Is RICO fair and just? Does it promote the objectives of compensation and deterrence that are ascribed to it by its advocates? These are questions I will address here. I have taken litigation against professionals as the point of departure in order to draw upon my own experience.

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1 For example, the author continues to represent one of the accounting firm defendants in the RICO case that led to the decision in Schacht v. Brown, 711 F.2d 1343 (7th Cir.) *cert. denied*, 464 U.S. 1002 (1983) (one of the leading cases approving the use of civil RICO in the business tort context).

I. The Position of Professionals

Professionals *are* worried about RICO. The American Institute of Certified Public Accountants, for example, has been in the forefront of some of the legislative efforts to amend RICO to limit the statute's reach. Moreover, many members of the organized bar have voiced opposition to the present breadth of the application of civil RICO. The reservations of many business lawyers were expressed in 1985 by the report of the Ad Hoc Civil RICO Task Force (chaired by a participant in this Symposium) of the American Bar Association Section of Corporation, Banking and Business Law. The organized bar is divided; countervailing views were put forth by other bar groups.[2] But lawyers today are voicing reservations about RICO, in marked contrast to the much more diffident stance of the organized bar a decade ago, when RICO was enacted.

At first glance, it might appear puzzling that professionals are in the forefront of proposals to curtail RICO. The accounting profession is widely regarded, and rightly so, as a profession of high integrity.[3] The legal profession, though perhaps not superior in moral fiber to society in general, is certainly not worse. My thesis is that professionals today feel especially vulnerable to RICO, not because they perceive their own conduct as particulary culpable, but because they view RICO as reinforcing and exacerbating trends in the law that have discarded or eroded longstanding prudential limitations on a professional's liability for economic loss. These trends have now exposed professionals to enormous, potentially indeterminate damages wholly disproportionate to the professional's undertaking or conduct. This consequence has resulted from a variety of interrelated factors: erosion of traditional limitations on a professional's liability for negligence; expansion of standing doctrines that have traditionally limited exposure; erosion of the scienter requirement essential to establishing fraud; and a blurring of sharp definitions of proximate cause.

Ironically, developments increasing the exposure of professionals have occurred at the same time the law has responded sympathetically to pleas from corporate directors that personal liability arising from directorial actions should be curtailed. In many states, a director now enjoys protection from personal liability so long as there is no evidence of self-dealing or personal gain from the challenged conduct. The result of these countervailing developments is that in cases of business failure, the "innocent victims"—shareholders, creditors, and those who purport to sue for their benefit—turn increasingly to professionals, indeed, sometimes *exclusively* to professionals, for economic redress.

The emergence of civil RICO is not solely responsible for these developments, but civil RICO has exacerbated those tendencies of the law to target professionals as deep pockets. Not only has RICO spurred the search for deep pockets by the lure of treble damages, the rhetoric of RICO has significantly distorted the formulation of legal principles and

2 *See A Comprehensive Perspective on Civil and Criminal RICO Legislation and Litigation*, RICO CASES COMMITTEE, 1985 A.B.A. SEC. CRIM. JUSTICE.

3 *See, e.g.*, Dileo v. Ernst & Young, 901 F.2d 624, 629 (7th Cir. 1990).

has skewed analysis in favor of greater liability. Thus, modification of existing RICO law—whether legislatively or judicially—is probably an essential first step to restoring balance and reason to the liability of professionals.

II. The Non-RICO Background

RICO, as I have indicated, is not solely responsible for the present state of the law concerning the exposure of professionals. Accordingly, I first review some of the significant developments apart from RICO.

A. *Negligence and the "Privity" Rule*

For decades, a professional's exposure to damages for negligence was limited by the "privity" rule espoused by Chief Judge Benjamin Cardozo, writing for the New York Court of Appeals in *Ultramares Corp. v. Touche*.[4] The case was brought by a factoring firm, Ultramares Corporation, that had extended credit to an importer, Fred Stern & Co., and was left unpaid when Stern declared bankruptcy. The plaintiff, Ultramares, then turned to the defendant accounting firm, Touche Niven & Co., which had audited Stern's financial statements on which Ultramares allegedly relied in extending credit. Ultramares alleged that where Stern's financial statements showed a solvent company, in reality, Stern's management had created fictitious assets to conceal an insolvency. Ultramares asserted both negligence and fraud claims against the accounting firm for failure to uncover Stern's fraud.

Judge Cardozo ruled that, while the defendant accounting firm could be liable for Ultramares' loss if the accountants had committed fraud, the accountants were protected from liability for negligence alone. Cardozo refused to allow the negligence liability of an accountant to extend to all foreseeable losses, and instead adopted the "privity" rule: the accountant was not liable for Ultramares' loss because Ultramares was not in "privity." Cardozo, fifteen years earlier, had rejected contractual privity as a limitation on the consequences of a manufacturer's negligence in *MacPherson v. Buick Motor Co.*,[5] and had observed that in that context "[t]he assault upon the citadel of privity is proceeding . . . apace."[6] Nonetheless, Cardozo rejected the analogy between an accountant's negligent "slip" and a defective physical product. The absence of a privity rule, Cardozo reasoned, would "expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class"—"too extreme" a burden for the law to sensibly create.[7]

The "privity" rule of *Ultramares* has been important in placing bounds on the liability of many professionals—accountants, lawyers, appraisers and title abstractors, to name only a few. Despite criticism of the rule—which swelled in the 1970s and 1980s, but may have peaked—the

4 255 N.Y. 170, 174 N.E. 441 (1931).
5 217 N.Y. 382, 111 N.E. 1050 (1916).
6 255 N.Y. at 180, 174 N.E. at 445.
7 *Id.* at 179-80, 174 N.E. at 444.

concerns expressed by Judge Cardozo remain firmly embedded in the law of professional liability.

The leading decision to criticize and reject the "privity" rule was the 1983 decision by the New Jersey Supreme Court, *Rosenblum, Inc. v. Adler*.[8] The New Jersey court viewed the privity rule as an anachronism by considering what the court perceived to be a change in certified public accountants' function over time. The court stated:

> At one time the audit was made primarily to inform management of irregularities and inefficiencies in the business. . . . Gradually a need for independent audits was generated by public ownership of business enterprises and by requirements of the stock exchanges and the Securities and Exchange Commission (SEC). Institutional investors, investment specialists, stockholders, and lenders demanded more and reliable information. It is now well recognized that the audited statements are made for the use of third parties who have no contractual relationship with the auditor. Moreover, it is common knowledge that companies use audits for many proper business purposes, such as submission to banks and other lending institutions that might advance funds and to suppliers of services and goods that might advance credit. . . . These uses as well as governmental requirements make financial statements reviewed by independent qualified accountants indispensable.[9]

The *Rosenblum* court dismissed as inconsequential Judge Cardozo's articulated concern about subjecting professionals to "indeterminate" liability. To the *Rosenblum* court, this concern was solved simply by loss spreading, the same solution the court clearly believed was taking place in response to the expansion of the product liability occurring at the same time. The court stated perfunctorily that inasmuch as accountants had "been able to obtain insurance covering" their existing liability, there was "no reason to believe" that insurance would not also cover liability under broader liability rules.[10]

Some observers predicted that the "privity" concept would be obliterated,[11] but this has not happened. While a few jurisdictions followed New Jersey's *Rosenblum*,[12] a greater number have retained the privity concept in some form. New York itself reconsidered the *Ultramares* rule and eventually reaffirmed it in 1985.[13] Today, most jurisdictions follow an approach requiring privity, or a variation based upon section 552 of the

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8 93 N.J. 324, 461 A.2d 138 (1983).

9 *Id.* at 345, 461 A.2d at 149.

10 *Id.* at 349 & n.11, 461 A.2d at 151 & n.11.

11 *See, e.g.*, Recent Developments, Rosenblum, Inc. v. Adler: *CPA's Liable At Common Law to Certain Reasonably Forseeable Third Parties Who Deterimentally Rely on Negligently Audited Financial Statements*, 70 CORNELL L. REV. 335 (1985); Recent Decisions, *Tort Law — The Enlarging Scope of Auditors' Liability to Relying Third Parties*, 59 NOTRE DAME L. REV. 281 (1983); New Jersey Developments, Rosenblum, Inc. v. Adler: *The New Jersey Supreme Court Expands Accountants' Liability*, 37 RUTGERS L. REV. 161 (1984).

12 *See, e.g.*, Touche Ross & Co. v. Commercial Union Ins., 514 So. 2d 315 (Miss. 1987); International Mortgage Co. v. John P. Butler Accountancy Corp., 177 Cal. App. 3d 806, 223 Cal. Rptr. 218 (1986); Citizens State Bank v. Timm, Schmidt & Co., 113 Wis. 2d 376, 335 N.W.2d 361 (1983).

13 Credit Alliance Corp. v. Arthur Anderson & Co., 65 N.Y.2d 536, 483 N.E.2d 110, 493 N.Y.S.2d 435 (1985).

Restatement (Second) of Torts.[14] Moreover, almost without exception, the few courts that have abandoned the privity rule entirely have voiced a need to replace it with some other doctrine to guard against unbounded liability.[15]

In addition to the rejection of the privity rule in some jurisdictions, the rule has become a less significant limitation on the liability of professionals than it once was. The diminished importance of the privity rule results from other parallel developments, discussed below.

B. *Erosion of the Scienter Requirement for Fraud*

The privity requirement applied where a professional was sued for negligence. Where fraud is alleged, a professional has traditionally faced broader liability under common law, under federal securities laws, and—more recently—under RICO. While some have argued that fraud-based liability should be of no concern to the honest professional, the argument fails to take into account a significant weakening of the scienter requirement of fraud that has occurred in practice. While the Supreme Court has declared that the "concepts of recklessness and negligence have no place" in criminal antitrust enforcement,[16] in other contexts the scienter element has been expanded to embrace "recklessness" in decisions of the lower federal courts.[17] Attempts have been made by appellate courts to tighten the concept of recklessness by reference to "conscious avoidance" or "willful blindness."[18] But the overall track record is mixed; no professional can be particularly confident that a deliberate intent to defraud will protect that professional against being second-guessed for a good faith error of judgment.

For example, in the wake of fraud convictions of top management at the National Student Marking Corporation, in the 1970s, a partner in a major accounting firm was prosecuted for having "recklessly" failed to react to "suspicious" facts suggesting that the partner was the victim of his client's fraud. At sentencing the trial judge indicated that no finding of the partner's actual knowledge of falsity and intent to deceive was necessary for conviction: "I think you are absolutely sincere when you say that you do not believe that you did anything wrong in this audit or au-

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14 For a review of case law, see Siliciano, *Negligent Accounting and the Limits of Instrumental Tort Reform*, 86 MICH. L. REV. 1929 (1988).

15 *See, e.g.*, *Rosenblum*, 93 N.J. at 328, 461 A.2d at 144; Citizens State Bank v. Timm, Schmidt & Co., 113 Wis. 2d 376, 387, 335 N.W.2d 361, 366 (1984) (articulating six factors to be considered in determining whether recoveries should be denied "under the facts of [a] particular case as a matter of policy"). Academic reaction to the privity rule has been mixed. A body of articles expressed criticism of *Ultramares* and enthusiastically embraced the New Jersey Supreme Court's decision in *Rosenblum*. *See* articles cited in Siliciano, *supra* note 14, at 1937-39. However, some commentators more recently have indicated that the criticism of *Ultramares* is unsound. Goldberg, *Accountable Accountants: Is Third-Party Liability Necessary?* 17 J. LEGAL STUD. 295 (1988); Siliciano, *supra* note 14.

16 United States v. United States Gypsum Co., 438 U.S. 422, 444 (1978).

17 *See, e.g.*, United States v. Benjamin, 328 F.2d 854, 862 (2d Cir.), *cert. denied sub nom.* Howard v. United States, 377 U.S. 953 (1964); United States v. Brien, 617 F.2d 299, 312 (1st Cir.), *cert. denied sub nom.* Labus v. United States, 446 U.S. 919 (1980).

18 *See, e.g.*, United States v. Jewell, 532 F.2d 697, 699-703 (9th Cir.), *cert. denied*, 426 U.S. 951 (1976); Bosco v. Serhant, 836 F.2d 271 (7th Cir. 1987). *See also Report of the Ad Hoc Civil RICO Task Force*, 1985 A.B.A. SEC. CORP. BANKING & BUS. L. 346-48.

dits. . . . But the tragedy is that the jury found that this was an audit or audits done with reckless disregard for what was really involved."[19] The Court of Appeals for the Second Circuit affirmed the conviction, *not* on the ground that the evidence was sufficient to find that the partner actually knew of his own client's fraud, but simply upon a determination that there was sufficient evidence that the professional knew of circumstances that were "suspicious."[20]

In another illustration of the same tendency, the SEC recently imposed administrative sanctions upon a broker/dealer in an opinion that deftly transformed "gross negligence" into scienter. The SEC equated a finding that the respondent was "grossly negligent" with recklessness and then equated reckless conduct with a "willful" violation of section 17 of the Securities Act of 1933.[21]

Such sleight of hand has demolished a considerable part of the protection theoretically afforded by a scienter requirement. Questions of intent and good faith are generally questions left to the trier of fact. Thus, even under the best of circumstances a professional will typically be judged by a jury of lay persons: a jury unfamiliar with the professional's discipline by their own experience and whose only information comes from a courtroom battle of experts. Even when the evidence is consistent with the professional's "good faith," the jury's opposite conclusion may be upheld.[22] When the line between intentional misconduct and negligence is blurred, jurors second-guess the professional with little more constraint than a general admonition to act reasonably—a situation that does little to inspire a professional's confidence in the law's fairness.

C. *Erosion of Standing Limitations*

Despite the loss of the privity rule for negligence actions as well as the weakening of the scienter requirement in some jurisdictions, a professional's liability has traditionally been bounded by doctrines of standing and causation. Where a professional has rendered service to a failed business entity, these doctrines have traditionally stood between the professional's insurance policy and the economic losses of everyone who is injured by a business failure. In the *Rosenblum* case, for example, the accountant was sued by a creditor of the bankrupt company that was the accountant's client. The court stressed that the accountant was liable to the plaintiff—with whom the accountant had no contact—because the plaintiff actually suffered economic loss from having obtained and relied upon the accountant's audit report on financial statements.[23]

Recently, however, these prudential limitations on a professional's exposure rooted in elementary standing requirements have begun to receive short shrift. Creative receivers and trustees of insolvent corporations have begun asserting that they are the proper parties to sue for the

19 Howard, *infra* note 35, at 62.

20 527 F.2d at 320.

21 *In the Matter of Bamberg*, Exchange Act Release No. 27672 (February 5, 1990).

22 County of Suffolk v. Long Island Lighting Co., 710 F. Supp. 1387, 1391-92 (E.D.N.Y. 1989), *aff'd on other grounds*, 907 F.2d 1295 (2d Cir. 1990).

23 93 N.J. at 351-53, 461 A.2d at 153.

losses of creditors who have made claims against their respective insolvent estates. On occasion, a receiver or trustee has asserted that the amount of a bankrupt company's insolvency (or some component of that amount) is an injury to the company itself, for which the company's representative may sue an outside professional. By this leap of logic, the bankrupt company's representative attempts to transform the economic losses of the company's creditors (which is what the insolvency represents) into a damage claim assertable by the company itself.

For example, the trustee of Auto-Train Corporation, a defunct railroad company, sued the company's outside auditors to recover essentially the entire shortfall between the company's assets and claims against the estate. Although the company's financial difficulties had been so severe that, for a number of years, the outside auditors had rendered opinions on the financial statements containing a going concern qualification, the trustee's theory was that the accountants should have given the company's outside directors more detail concerning the company's financial position and operations. The trustee asserted that the outside directors could then have taken steps that could have turned the company around. The trustee obtained an $11 million jury verdict against the accountants—a sum approximating the company's insolvency. Until reversed by the court of appeals because of insufficient evidence of causation, the judgment stood as a signal that the economic loss in the way of business failure may be visited upon a hapless, deep pocket professional.[24] Such efforts to end-run the traditional rules of standing have received a mixed reception in the courts.[25] However, a RICO case is one of the first cases to be receptive to the tactic.

In *Schacht v. Brown*,[26] the Court of Appeals for the Seventh Circuit considered a RICO complaint alleging that the officers and directors, outside auditors and reinsurers of an insolvent insurance company had conspired to conceal that company's insolvency from state regulators, with the alleged result that the company was allowed to stay in business and engage in operations that allegedly "deepened" the insolvency. The plaintiff was the state's top insurance regulator, appointed to act as liquidator of the insolvent company. In holding that the complaint stated a claim—the court did not address the merits of the controversy—the Seventh Circuit had to confront traditional standing doctrine indicating that the plaintiff had sustained no recoverable damages. Under state law, the state insurance regulator as liquidator was restricted to asserting claims of the insolvent company and could not assert the claims of creditors. The complaint alleged that the company had already been insolvent when the concealment fraud began, and, under traditional law, the

24 *See* Drabkin v. Alexander Grant & Co., 905 F.2d 453 (D.C. Cir. 1990).

25 *Compare, e.g.*, Caplin v. Marine Midland Grace Trust Co., 406 U.S. 416 (1972); Williams v. California First Bank, 859 F.2d 664 (9th Cir. 1988); Kelly v. Overseas Investors, Inc., 18 N.Y.2d 622, 219 N.E.2d 288, 272 N.Y.S.2d 773 (1966) *with* Schacht v. Brown, 711 F.2d 1343 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983); Corcoran v. Frank B. Hall & Co., 155 A.D.2d 314, 547 N.Y.S.2d 590 (N.Y. App. Div. 1989).

26 711 F.2d 1343 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983).

"worsening" or "deepened" insolvency caused no damage to the company, although obviously creditors were damaged.

However, the Seventh Circuit—perhaps impressed by the gravity of the offenses charged—decided to ignore that doctrine. The court invented a new rule that deepening of the insolvency amounts to damage to the corporation. The "corporate body is ineluctably damaged," the Seventh Circuit stated, "by the deepening of its insolvency, through increased exposure to creditor liability."[27] The court went on: "[I]n most cases, it would be crucial that the insolvency of the corporation be disclosed, so that the shareholders may exercise their right to dissolve the corporation in order to cut their losses."[28]This reasoning cannot be squared with the concept of limited liability by incorporation, which means that shareholders have no personal liability; when their corporation becomes insolvent, continued operations do not cause the shareholders additional "exposure," and they have no "losses" to "cut" by dissolution.

The *Schacht* result is best understood as a legal fiction permitting creditors' damages to be asserted against the defendants using the company's liquidator as a convenient plaintiff.[29] Adhering to traditional standing doctrine, the Seventh Circuit feared, would have created "perverse incentives for wrong-doing officers and directors."[30] (Ignored in this passage of the court's opinion were the professionals and other outsiders who were swept into the case as additional defendants.)

The *Schacht* result and the Seventh Circuit's langauge illustrate the pressure placed upon legal rules by the use of RICO. The *Schacht* court's modification of traditional standing rules has now been transplanted into non-RICO contexts. With increasing frequency, legal representatives of a failed enterprise now seek to shift to professionals all or part of a huge and indeterminate aggregation of the economic losses that fall upon third parties when there is a business failure. For example, it is alleged that an accountant's "negligent" audit allowed the client to submit audited financial statements that showed a healthy enterprise and perpetuated its existence. But for the accountant's negligence, it is alleged, the "truth" would have been discovered and the enterprise's troubles halted—often by regulatory takeover. Accordingly, the accountant—so it is alleged—is liable for all of the losses caused to creditors by the enterprise's failure, on the theory that the accountant contributed to the wrongful preservation of the enterprise's life.[31]

Accountants are currently the most frequent targets of such allegations; however, they are not the only professionals vulnerable. It has not

27 *Id.* at 1350.

28 *Id.*

29 In another case decided six years after *Schacht*, the Seventh Circuit articulated a more candid rationale for suits by the bankrupt entity. *See* Mid-State Fertilizer v. Exchange Nat'l Bank, 877 F.2d 1333, 1336 (7th Cir. 1989) ("recovery by the firm handles everything automatically—for investors, workers, lessors and others share any recovery according to the same rules that govern all receipts"). *Mid-State* makes sense only if all who share a recovery "automatically" are entitled to shift their losses to the defendant.

30 *Schacht*, 711 F.2d at 1350.

31 *See, e.g.*, Drabkin v. Alexander Grant & Co., 905 F.2d 453 (D.C. Cir. 1990).

taken long for those who administer estates having liabilities grossly exceeding the assets to realize that lawyers, as well as accountants, can be accused of wrongfully contributing to the perpetuation of an enterprise's life. A lawyer's opinion or preparation of a legal document, no less than the accountant's audit report, may be a practical necessity for an enterprise's continuation in business or consummation of a transaction. The lawyer, no less than the accountant, may find himself accused of contributing to a client's wrongdoing by offering professional services.

In theory, one can imagine fact patterns where the *Schacht* court's result-oriented doctrinal revisions appeal to a sense of justice. In the real world, however, where a professional's failure to discover someone else's wrongdoing and "blow the whistle" may be equated to fraud, which may be equated with a RICO violation, the ease with which the *Schacht* court dispensed with traditional protections afforded by the law justifiably chills responsible professionals.

D. *Erosion of Limitations Based Upon Proximate Cause*

The law has many strands that have been designed to make exposure manageable and predictable. The concept of proximate cause is frequently utilized to place limits on a person's liability. Likewise, the "economic loss" doctrine is utilized to keep liability from extending to losses remote from the defendant's conduct, even though linked to the defendant's conduct by a chain of causation-in-fact.[32]

The protection afforded professionals by these doctrines has, however, been quite uneven. The "economic loss" doctrine is another manifestation of the same concerns leading Judge Cardozo to endorse the privity rule for professional liability. Yet some courts have excluded accountants from its application. Moreover, concepts of proximate cause and remoteness have gone unmentioned in cases where accountants, law firms and lenders are accused of unlawfully prolonging the life of a company.[33]

E. *The Search for Professional "Deep Pockets"*

No one would seriously argue that a professional should be immunized for consequences of that professional's conduct if wrongful. All too often, however, our legal system has, in pursuit of compensation objectives, saddled a professional with liability wholly disproportionate to the professional's alleged misconduct. For example, in a recent securities litigation with which I am unfortunately all too familiar, four venture capital organizations turned to professionals to recover their losses in an exploration and development company that fell victim to the energy recession. The investors alleged that they had been defrauded by the com-

32 *See, e.g.*, Andersen Elec. Inc. v. Ledbetter Erection Corp., 115 Ill. 2d 146, 503 N.E.2d 246 (1986).

33 *See, e.g.*, Drabkin v. Alexander Grant & Co., 905 F.2d 453 (D.C. Cir. 1990); Tew v. Chase Manhattan Bank, 728 F. Supp. 1551 (S.D. Fla.), *amend in part*, 741 F. Supp. 220 (S.D. Fla. 1990) (Chase Manhattan Bank accused of wrongfully prolonging life of securities broker-dealer being looted by its own officers and directors).

pany's management at the time of the investment. But the investors recovered the entire amount of their investment—not from the company's managers, but from a law firm and accounting firm that failed to detect what was alleged to constitute wrongdoing by the company's managers.[34]

Examples such as this one are not happenstance. When there are widespread enterprise failures and a perceived need to recoup resulting economic loss—failures of insurance companies and financial institutions come immediately to mind—some immediately proclaim the availability of recovery from deep pocket professionals as the perfect solution to the problem. For example, one commentator on insurance insolvencies targets the independent accountants as the "defendant of choice" for a law suit brought to "infuse assets into the estate" of the insolvent insurance carrier.[35] Indeed, this commentator views accountants as "the defendant of choice" precisely *because* they are less to blame for the catastrophe:

> Auditors are preferred defendants for several reasons. First, it is more likely that they will have appropriate E&O insurance in place with high limits of liability. By contrast, those who mismanaged or defrauded their own concern may well have also been remiss in purchasing any, or adequate D&O insurance. Second, insurance aside, individual directors and officers are less likely to have deep pockets while independent accounting firms—especially the larger ones—will typically be organized as general partnerships and will have deep pockets. Third, even assuming adequate insurance is in place, the managers are more likely to be adjudged liable for fraud, and fraud is a conduct exclusion in virtually all D&O insurance policies. Thus, when an insurer's liquidator sues a defunct insurance company's managers and auditor, he is likely to view the suit against the accountants as more viable and as a more realistic means of maximizing the infusion of substantial assets into the insolvent's estate.[36]

Such realities have now provoked a number of lawsuits against accounting firms in the wake of insurance company insolvencies.[37]

The same impulse to find the deep pocket can be seen vividly in the wave of litigation that has commenced following the savings and loan crisis. The failure of savings and loan institutions places enormous demand upon the funds insuring deposits. Those who managed the failed institutions—and are accused of practices that are imprudent or worse—either cannot be found or have only modest resources. The government thus looks to deep pockets—for example, accountants and lawyers who provided services to failed thrifts—on which to lay off some of the large losses. The FDIC has commenced a number of lawsuits against auditors

34 *See, e.g.*, Sioux, Ltd., Sec. Litig. v. Coopers & Lybrand, 914 F.2d 61 (5th Cir.), *rev'g on rehearing*, 901 F.2d 51 (5th Cir. 1990).

35 D. Howard, *Making Accountants Account For Themselves When An Insurance Company Has No More Tomorrows*, February, 1990 INSURANCE LITIGATION RPTR. 60.

36 *Id.*

37 *See, e.g.*, Schacht v. Brown, 711 F.2d 1343 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983); Merin v. Yegen Holdings Corp., 240 N.J. Super. 480, 573 A.2d 928 (N.J. Super. Ct. App. Div. 1990); Corcoran v. Frank B. Hall & Co., 149 A.D.2d 165, 545 N.Y.S.2d 278 (N.Y. App. Div. 1989).

of the financial statements of failed thrifts with damages demanded aggregating into the billions of dollars.[38] Lest lawyers feel left out, it should be noted that the FDIC has taken a similar approach with respect to law firms.[39]

III. The Contribution of RICO to the Search for Deep Pockets

Although the search for the deep pocket did not originate with RICO, RICO has given the search added impetus by raising the stakes in civil litigation to treble damages. Treble damages become a weapon to induce settlement. The commentator favoring accountants as the "defendant of choice" in insurance insolvency litigation enthusiastically notes:

> [T]o induce an earlier and more favorable settlement, the [liquidator] will wish to charge the auditor not merely with negligence or breach of contract, but with common law and statutory fraud (such as RICO) because the latter counts create the prospect of recovering punitive or treble damages as well as costs and counsel fees.[40]

RICO has also exacerbated the uncertainty that has resulted from blurring the line between "fraud" and innocent conduct which may be criticized by hindsight. The concept of "fraud" from RICO's mail and wire fraud predicates is an elastic one which risks subjecting professionals simply to being second-guessed. Before the passage of RICO, when mail and wire fraud statutes were the exclusive province of prosecutors, courts were inclined to interpret "scheme to defraud" in open-ended fashion, relying upon prosecutorial discretion to sort out culpable from non-culpable conduct. Thus, appellate courts have written expansive language such as this statement from the Fifth Circuit:

> The fraudulent aspect of the scheme to "defraud" is measured by a nontechnical standard. Law puts its imprimatur on the accepted moral standards and condemns conduct which fails to match the "reflection of moral uprightness, of fundamental honesty, fair play and right dealing in the general and business life of members of society."[41]

Given the imprecision with which "fraud" is defined as a RICO predicate, an argument frequently made by RICO enthusiasts—that no innocent person should worry because "good faith" is a complete defense—is out of step with real-world practice.

Finally, RICO has distorted the analysis and application of traditional, salutary legal doctrine. It will be recalled that it was a RICO case, *Schacht v. Brown*, that introduced uncertainty into the concepts of standing, causation and damages when a trustee or receiver sues a profes-

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38 *Suits Target Deep Pockets of Accountants*, American Banker, March 13, 1990, at 1, col. 1.

39 *See, e.g.*, FDIC v. Bauman, Civ. Action No. 3-90-614-H (N.D. Tex. 1990); FDIC v. Wise, No. 90-1688 (D. Colo. 1990); Harlan & Barrett, *FDIC Sues Dallas-Area Lawyers in Vernon*, Wall St. J., Mar. 21, 1990, at B8, col. 1; *Government Targets Lawyers in Thrift Suits*, Nat. L. J., Apr. 2, 1990, at 5, col. 1.

40 Howard, *supra* note 35, at 60.

41 Blachly v. United States, 380 F.2d 665, 671 (5th Cir. 1967) (quoting Gregory v. United States, 253 F.2d 104, 109 (5th Cir. 1958)). *But see* Reynolds v. East Dyer Dev. Co., 882 F.2d 1249 (7th Cir. 1989) (criticizing *Blachly*).

sional in the wake of a corporate insolvency. The uncertainty caused by *Schacht* may eventually be corrected by the courts. In the meantime, however, it results in uncertainty and untold litigation expense and burden for professionals who happen to be convenient targets in the wake of a business failure.

IV. Problems and Solutions

The imposition of disproportionate liability upon professionals has created a serious imbalance. People first in line for moral condemnation are ignored in the search for money. Peripheral figures and their insurance carriers become the exclusive sources of monetary recovery. This imbalance is real, not merely theoretical. Few observers of the savings and loan crisis expect that a large part of the cleanup cost will be recovered from people who managed the thrifts into insolvency or borrowers who defaulted.[42] However, the FDIC has begun multimillion dollar lawsuits against accounting firms and law firms to lay off part of the enormous government obligations to deal with failed thrift institutions.[43]

This imbalance is offensive to deep-seated concepts of justice. Proportionality of the sanction to the culpability of the conduct is an important part of our law. The "principle of proportionality" has been recognized by the Supreme Court to be "deeply routed and frequently repeated in common-law jurisprudence" and has been made the basis of eighth amendment analysis.[44]

By placing a disproportionate monetary burden on those who, although comparatively free of blame, happen to have resources, the deep pocket approach has serious costs. This approach dilutes the moral force of the law and breeds cynicism on the part of those deep pockets who are targets. This is disturbing to professionals, and it should be disturbing to everyone. Professionals are the people frequently relied upon to inject considerations of propriety in business transactions. The Securities and Exchange Commission, for example, has proclaimed:

> The important role which professionals, particularly attorneys and accountants, play in assuring adherence to the Federal Securities laws has long been recognized. Clearly, the Commission would be unable to administer effectively those laws in an environment in which issuers, underwriters, and others involved in the capital-raising process were not routinely served by professionals of the highest integrity and competence, well-versed in the requirements of the statutory scheme Congress has created.[45]

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42 *See Fraud Was Only A Small Factor In S & L Losses, Consultant Asserts*, Wall St. J., July 20, 1990, A2, col. 1.

43 *See, e.g.*, Villa & Murphy, *Emerging Theories of Liability For Lending Counsel*, in PLI *Litigating For and Against The FDIC and the RTC* 257 (1990).

44 Solem v. Helm, 463 U.S. 277, 284 (1983).

45 *In re* Carter, Fed. Sec. L. Rep. (CCH) ¶ 82,847, at 84, 148 (1981) (citation omitted). *See also In re* Fields, 45 S.E.C. 262, 266 n.20 (1973), *aff'd*, 495 F.2d 1085 (D.C. Cir. 1974) (noting the "strategic and especially central place of the private practicing lawyer in the investment process and in the enforcement of the body of federal law aimed at keeping that process fair. . . . The task of enforcing the securities laws rests in overwhelming measure on the bar's shoulders. . . .").

Targeting professionals for disproportionate liability is sometimes defended on the ground that this is the most effective way to minimize the consequences of the wrongful conduct of others that cannot be eliminated. We cannot reform the corrupt, the argument goes, but we can make the incorruptible professionals even more careful.

Although this approach has from time to time influenced the enforcement strategies of government agencies,[46] the argument is dubious at best. Professionals inevitably sued in the wake of financial disasters on the theory that they could have been more careful, taken an extra step, given an extra warning, can reasonably conclude that they will be sued no matter what they do, given their resources and the attraction to find a deep pocket defendant that must pay. When the law sends that message, its deterrent power is dissipated. The power to encourage proper conduct exists only if there is some benefit—i.e., freedom from exposure—from conformity. If an individual will be sued no matter what his conduct, what incentive is there to exercise care?

Changing RICO will not solve the problem, but RICO reform would be a start. Several sessions of Congress have wrestled with RICO reform proposals, and while I am sympathetic to the objectives of those proposals, I offer here a mere modest first step that may have wider political acceptability. Automatic trebling of damages in civil RICO cases should be abolished. Instead, trebling should occur only in conjunction with procedures designed to preclude damages disproportionate to a defendant's conduct. Under tort reform statutes of several states, the fact finder is required to compare a given defendant's responsibility for the plaintiff's loss with the responsibility of others who contributed to that loss—whether or not the others are parties to the case, whether because of lack of resources or otherwise.[47] The fact finder's assignment of relative responsibility to the defendant determines the actual damages recoverable from that defendant. Some federal courts have mandated an analogous procedure in multi-defendant cases when a plaintiff settles with some defendants and proceeds to trial against others.[48]

If such devices are acceptable limitations when dealing with a plaintiff's actual damages, they are even more justifiable if one decides to regulate the component of RICO damages which, by definition, goes beyond compensating the plaintiff for actual injury. Regulating and limiting imposition of the noncompensatory component of civil RICO damages will not solve the problem of disproportionate professional liability, but this modest reform will at least be a start.

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46 *See* Securities and Exchange Comm'n v. Arthur Young & Co., 590 F.2d 785 (9th Cir. 1979); Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490 (7th Cir. 1986).

47 *See, e.g.*, COLO. REV. STAT. § 13-21-111.5 (1989); *see also In re* Air Crash Disaster at Stapleton Int'l Airport, 720 F. Supp. 1465 (D. Colo. 1989) (for a discussion of the statute's operation).

48 *See, e.g.*, Franklin v. Kaypro Corp., 884 F.2d 1222 (9th Cir. 1989); Alvarado Partners v. Mehta, 723 F. Supp. 540 (D. Colo. 1989).