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L. Gordon Crovitz

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How the RICO Monster Mauled Wall Street

*L. Gordon Crovitz**

I. Introduction

On Wall Street, the 1980s will be remembered for an investment banker and a U.S. Attorney armed by the Justice Department with broad use of a killer statute. The banker, instead of sticking to the usual activities of underwriting and brokerage made an epoch discovery about the true measure of high-yield bonds, now called junk bonds. Partly as a result, hundreds of small firms found access to capital they never had before, more jobs were created in the U.S. than in Europe and Japan combined, the economy boomed. There was also the ready capital to fund the market for corporate control—takeovers, leveraged buy-outs, restructurings—that serves as the ultimate solution to the problem of the separation of ownership and control of firms.

This caused great dislocations and in some quarters great anger. Competitors resented the success of the upstart firm Drexel Burnham Lambert. The Securities and Exchange Commission and the U.S. Attorneys' Office in Manhattan decided that Michael Milken had to be brought down. There was nothing illegal in junk bonds or hostile takeovers, but RICO was the way out of this irrelevancy. His hundreds of thousands of trades were analyzed. Despite the fact that the best prosecutors could find were alleged regulatory offenses, almost none of which had ever before been treated criminally, and where any victims remain very hard to find, RICO was the perfect club. Call him a racketeer, guilty of "frauds" and call him greedy, a sleaze, and see if a jury will disagree.

As seen from this perspective, as at least some of Wall Street does, RICO looms large indeed. Wall Street traders, bankers, analysts, accountants and others paid close attention to the use of RICO. Many of them, with good reason, view themselves as there-but-for-the-grace-of-God defendants. No one can know whether they may inadvertently some day become defendants under the vague RICO predicates of mail fraud, wire fraud or securities fraud. They see the forest and not just the trees. They see a forbidding RICO forest, not a few twisted and perhaps imperfect trees as it is often described by courts and commentators.

This paper will offer a view of RICO from Wall Street, so a history from the Wall Street perspective of this title of the Organized Crime Control Act of 1970 is appropriate before describing how it was used on Wall Street and with what effects. RICO began in 1970 as a well-inten-

* L. Gordon Crovitz is Assistant Editorial Page Editor of The Wall Street Journal, where he writes the weekly "Rule of Law" column. His editorials and articles on abuses of RICO were recognized during 1990, for first-place awards from the Gerald Loeb Award competition and from the New York State Bar Association. He is a graduate of the University of Chicago and has law degrees from Wadham College, Oxford University, which he attended as a Rhodes scholar, and Yale Law School.

tioned law aimed at strengthening the hand of prosecutors against organized crime syndicates, but Wall Street has learned that RICO, without congressional intent, has become a tool of both prosecutors and private plaintiffs against legitimate businesses. Note that RICO's more precise legislative name is Title IX of the Organized Crime Control Act of 1970.¹ Despite its current use in these ways, RICO is not a law aimed at handcuffing investment bankers at their desks to force compliance with the securities laws or at granting jurisdiction to federal courts to hear state common law actions for damages in suits arising in situations as diverse as interpreting dispositions under wills, divorce actions and property damaged during civil disobedience. Instead, RICO is part of a larger statute aimed entirely at organized crime and organized criminals. The text and legislative history makes clear that the statute was aimed directly at the Mafia, La Cosa Nostra, the Mob.²

Despite this fundamental context for RICO, by the mid-1980s, many criminal RICO cases were aimed at a new breed of alleged criminals that had no ties to organized crime. On the civil side, the American Bar Association (ABA) reported that more than ninety percent of the RICO cases between private parties were for damages against legitimate businesses.³

How has this happened? Some RICO defenders now argue that RICO was intended as a broad weapon, not limited to organized crime. This seems highly unlikely. One of the original proposals was that Congress include in the Organized Crime Control Act a simple provision to accomplish the goal of strengthening the hand of prosecutors against the mobsters that had long confounded law enforcement. This proposal was simply to make it a crime to belong to the Mafia, La Cosa Nostra or other organized criminal syndicates. Rep. Mario Biaggi, Democrat of New York, offered a provision that would have simply read, "It shall be unlawful for any person to be a member of a Mafia or a Las Cosa Nostra Organization." He defined these organizations as "nationally organized criminal groups composed of persons of Italian ancestry forming an underworld government ruled by a form of broad of directors, who direct or control the national operation of a criminal enterprise in furtherance of a monopolistic trade-restraining criminal conspiracy."⁴ This proposal had its own problems, but would have had the great virtue of aiming the law with some precision at its intended targets.

Instead, we have a statute that refers to "racketeering," "patterns," "predicate acts" and "enterprises." Why? The Biaggi proposal was defeated not because Congress decided to broaden the targets under the anti-organized crime law, but because Congress wanted to ensure that the Supreme Court would not invalidate the entire law. The problem identified at the time was that the Supreme Court had prohibited "status

1 Pub. L. No. 91-452, tit. IX, § 901(a), 84 Stat. 941, 941 (codified as amended at 18 U.S.C. §§ 1961-1968 (1988)) [hereinafter RICO].

2 This section is based on Crovitz, *RICO: The Legalized Extortion and Shakedown Racket*, in *THE RICO RACKET* (G. McDowell ed. 1989).

3 *Report of the Ad Hoc Civil RICO Task Force*, 1985 A.B.A. SEC. CORP. BANKING & BUS. L. 56 [hereinafter *Civil RICO Task Force Report*].

4 *Id.* at 118.

crimes" as unconstitutional, and so, it was argued, a law prohibiting membership in the Mafia would be unconstitutional. Congress was advised by legal scholars instead to craft a law that would apply to the activities of mobsters, without making the crime mere membership in the Mob. The commission of two of the listed predicate acts within a ten-year period would establish an enterprise as a racketeering enterprise, and subject its members to the rigors of RICO enforcement.

The decision to craft a law that would catch mobsters indirectly by defining their classic activities led to two unintended consequences.

The first was that proponents of the law were forced by opponents to make statements that seemed to suggest that the law was not what it was—an indirect way of establishing a status crime. Civil libertarians who opposed tougher laws even for mobsters raised the specter of RICO as a status crime that unfairly and unconstitutionally targeted individuals in fact for belonging to the Mob—a status crime by another name. As a result, several congressmen assured opponents of the legislation and, not incidentally, future judges interpreting the constitutionality of the law, that of course others would also be caught by the law. One of the leading supporters, Senator John McClellan, Democrat of Arkansas, defended his bill by saying, "[T]his objection seems to imply that a double standard of civil liberties is permissible Has the [American Civil Liberties] [U]nion forgotten that the Constitution applied to those engaged in organized crime just as it applies to those engaged in white-collar or street crime? S. 30 must, I suggest, stand or fall on the constitutional questions without regard to the degree to which it is limited to organized crime cases."⁵

Compare this with the broader purposes of the law. The statement of findings in the preface to the Organized Crime Control Act make it clear that the only relevance to legitimate business is as a plaintiff against organized criminals or as a conduit for the financial activities of mobsters. The preface is worth citing for the utter absence of any reference to ninety percent of the civil cases now brought under RICO:

The Congress finds that (1) organized crime in the United States is a highly sophisticated, diversified, and widespread activity that annually drains billions of dollars from America's economy by unlawful conduct and the illegal use of force, fraud, and corruption; (2) organized crime derives a major portion of its power through money obtained from such illegal endeavors as syndicated gambling, loan sharking, the theft and fencing of property, the importation and distribution of narcotics and other dangerous drugs, and other forms of social exploitation; (3) this money and power are increasingly used to infiltrate and corrupt legitimate business and labor unions and to subvert and corrupt our democratic processes; (4) organized crime activities in the United States weaken the stability of the Nation's economic system, harm innocent investors and competing organizations, interfere with free competition, seriously burden interstate and foreign commerce, threaten the domestic security, and undermine the general welfare of the Nations and its citizens; and (5) organized crime contin-

5 111 CONG. REC. 18,913-14 (1970).

ues to grow because of defects in the evidence-gathering process of the law inhibiting the development of the legally admissible evidence necessary to bring criminal and other sanctions or remedies to bear on the unlawful activities of those engaged in organized crime and because the sanctions and remedies available to the Government are unnecessarily limited in scope and impact.

It is the purpose of this Act to seek the eradication of organized crime in the United States by strengthening the legal tools in the evidence-gathering process, by establishing new penal prohibitions, and by providing enhanced sanctions and new remedies to deal with the unlawful activities of those engaged in organized crime.⁶

Despite Senator McClellan's assurances to the ACLU, one looks in vain to any reference to the prospect of RICOing legitimate business except where it is used as a conduit for organized crime.

Instead, the Senate Judiciary Committee report on the RICO provision makes clear that its only impact on legitimate business was meant to be where mobsters used ordinary commerce for their illicit ends. The report said that RICO "has as its purpose the elimination of the infiltration of organized crime and racketeering into legitimate organizations operating in interstate commerce."⁷ That the target was organized crime corrupting legitimate businesses and not legitimate businesses violating other laws is clear from the Senate report's explanation that RICO was needed because organized crime had infiltrated legitimate businesses. "In most cities, organized crime now dominates the fields of jukebox and vending machine distribution," the report said.⁸

Racketeers in one midwestern city control, or have large interests in 89 businesses with total assets of more than \$800 million and annual receipts in excess of \$900 million. Laundry services, liquor and beer distribution, nightclubs, food wholesaling, record manufacturing, the garment industry and a host of other legitimate lines of endeavor have been invaded and taken over.⁹

The second perverse result of the decision to use predicate "racketeering" acts instead of simply prohibiting membership in an organized crime organization was that, in retrospect, RICO gave prosecutors and plaintiff lawyers unprecedented powers to bring cases based on minimal or no evidence. RICO replaced the already relaxed legal requirement to establish conspiracy with the simple accusation of two predicate acts. Moreover, the drafting of RICO did not limit the predicate acts to loan-sharking, embezzlement, extortion, murder or lacing concrete shoes onto a competitor and dumping him in the East River. Instead, and largely as afterthoughts with very little legislative history, three alleged activities were added that could apply to mobsters, but also apply to thousands of legitimate businesses, certainly including Wall Street investment banks, accountants and others involved in the capital markets: mail fraud, wire fraud, and securities fraud.

6 116 CONG. REC. 602 (1970).

7 ORGANIZED CRIME CONTROL ACT, S. REP. NO. 617, 91st Cong., 1st Sess. 76 (1969).

8 *Id.*

9 *Id.*

This is especially significant now that the ABA has determined that more than ninety percent of the private, civil RICO lawsuits are against legitimate businesses, labor unions, spouses in divorce actions and heirs in challenges to dispositions under wills. It is also significant because the ABA found that claims of mail fraud, wire fraud or securities fraud have become the typical predicate acts for RICO. Some forty-four percent of the cases rely solely on allegations of mail or wire fraud. Another thirteen percent rely primarily on mail or wire fraud, but also allege another predicate act, while twelve percent focus on another predicate act but also allege mail or wire fraud. Thus more than two-thirds of the cases include mail or wire fraud charges. The ABA report found that about thirty-five percent of the civil RICO cases rely solely or primarily on allegations of securities fraud. Interestingly, no predicate acts aside from mail fraud, wire fraud or securities fraud occurred in as many as two percent of the cases.¹⁰ Justice Thurgood Marshall has noted that:

The effects of making a mere two instances of mail or wire fraud potentially actionable under civil RICO are staggering, because in recent years the Courts of Appeals have tolerated an extraordinary expansion of mail and wire fraud statutes to permit federal prosecution for conduct that some had thought was subject only to state criminal and civil law.¹¹

Mail and wire fraud are the heirs to a troubling tradition in the American legal system—the catch-all criminal provision that may do justice so long as prosecutors use great care and exercise unusual discretion, but can become effective rubber hoses in the hands of overly zealous prosecutors. RICO's predecessors include the broad charge of conspiracy, which de-emphasizes the traditional *mens rea* requirement in the Anglo-American justice system. By 1925, Judge Learned Hand referred to the conspiracy charge as “the darling of the modern prosecutor’s nursery.”¹² By lowering the required proof of conspiracy to the allegation of predicate acts, RICO is the darling of today’s prosecutor’s nursery.

This is especially so because mail and wire fraud is itself a powerful tool in the hands of prosecutors. “Fraud” is inherently ambiguous, which makes it a troubling part of any criminal code. It has been a fundamental notion of our law since the time of Blackstone that the rule of law is undermined by vague criminal laws—laws that are impossible to follow but very easy to break inadvertently. Allegations of mail or wire fraud are nothing more than allegations that some “fraud” was committed though the mails or telephone wires. Prosecutors have long viewed the mail and wire fraud statutes as powerful tools. Former prosecutor Jed Rakoff has written that “[t]o federal prosecutors on white collar crime, the mail fraud statute is our Stradivarius, our Colt 45, our Louisville Slugger, our Cuisinart—and our true love.”¹³ Almost no business—legitimate or ille-

¹⁰ See *Civil RICO Task Force Report*, *supra* note 3, at 57.

¹¹ *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 502 (1985) (Marshall, J., dissenting) (quoting *United States v. Weiss*, 752 F.2d 777, 791 (2d Cir. 1985) (Newman, J., dissenting)).

¹² *Harrison v. United States*, 7 F.2d 259 (2d Cir. 1925).

¹³ Rakoff, *The Federal Mail Fraud Statute (Part I)*, 18 DUQ. L. REV. 771 (1980).

gitimate—is done without letters, FAXes or modems. This means that nearly any allegation of “fraud” can now become a RICO case.

There is a fascinating history to the inclusion of securities fraud as a predicate act under RICO at the same time as mail fraud and wire fraud were added to the list of predicates. The Department of Justice had testified against an earlier version of RICO that did not include these three predicates arguing that even without these, the predicates, including state law offenses, were already “too broad and would result in a large number of unintended applications.”¹⁴ RICO did not include any reference to securities fraud until the final version of the law to be reported out of the Senate Judiciary Committee in December, 1969.¹⁵

This timing is crucial to understanding the purpose of including securities fraud because it was during this period that law-enforcement authorities first became concerned about the involvement of criminal syndicates in the securities markets, especially in the stealing and reselling of securities. The President of the New York Stock Exchange, Robert Haack, testified before a House Committee in February, 1969, about a dramatic increase in thefts of securities allegedly by criminal syndicates.¹⁶ In March, 1969, Attorney General John Mitchell testified that organized crime syndicates had even begun to use their huge financial resources to manipulate the prices of some securities.¹⁷ The modus operandi apparently was quite simple. Senator Roman Hruska explained that “persons with known underworld ties” would penetrate an “established brokerage house” and begin to circulate rumors to run up the prices of certain shares and engage in other manipulation.¹⁸ In other words, the target was not securities fraud by legitimate brokers or bankers, but fraud against legitimate firms in the securities business by mobsters. Put another way, there is no evidence that Congress intended to replace the Securities Act of 1933 and 1934 with RICO; fraud in the sale of securities by regulated brokers was already well covered by the criminal code.

In a quirk of history, the chairman of the American Bar Association ad hoc group that produced the ABA’s 1985 report on civil RICO, Arthur F. Mathews, was the deputy associate director for enforcement in the Securities and Exchange Commission in 1969. The ABA report includes his recollection of why the SEC supported the inclusion of securities fraud as a predicate act. “The SEC’s views in 1969 were predicated on a belief by its enforcement staff that organized criminal syndicates were becoming involved in manipulations of listed securities traded on major national securities exchanges, particularly the American Stock Exchange,” the report said.¹⁹ The purpose was thus clearly not to facilitate

14 See *Civil RICO Task Force Report*, *supra* note 3, at 99.

15 116 CONG. REC. 972 (1970).

16 *Securities Markets Agencies: Hearings on the Administration of the Laws Pertaining to the Regulation of the Securities Markets by the Administrative Agency and by the Self-Regulatory Agencies Involved Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 91st Cong., 1st Sess. 137 (1969).

17 115 CONG. REC. 5,874 (1969).

18 113 CONG. REC. 17,998 (1967).

19 See *Civil RICO Task Force Report*, *supra* note 3, at 99 n.130.

law enforcement against legitimate brokerages, but only against organized crime that used legitimate brokerages.

Moreover, the ABA report made clear that the SEC did not anticipate the private civil RICO suits alleging securities losses that have now become so common. "No consideration was given by the SEC at the time to the possibility that the statutes when eventually enacted might contain an express private cause of action for treble damages on behalf of victims," the ABA report said, "which might in any way implicate or replace the traditional securities statutes."²⁰

Some critics feared at the time RICO was passed that it could be misinterpreted as applying to securities fraud by legitimate businesses. The Association of the Bar of the City of New York and the New York County Lawyers Association both testified against RICO on these grounds. The latter made the point explicitly that the statute could some day confuse securities law with this new law aimed at organized crime. "Fraud in the sale of securities," the group testified, "is simply not synonymous with racketeering activity."²¹ How times change.

II. Whatever Happened to RICO Prosecutorial Guidelines?

The use of RICO in the 1980s by federal prosecutors, especially by former U.S. Attorney for Manhattan, Rudolph Giuliani, against alleged white-collar criminals, especially alleged inside traders, completely confounds the purpose, text and history of the statute. Although Mr. Giuliani also used RICO with some success against Mafia families in several cases, he revolutionized law enforcement by applying RICO's draconian provisions for pre-trial restraints and government-approved allegations of "racketeering" to entirely new kinds of cases and defendants. His most highly publicized insider trading cases, especially his investigation of the investment banking firm of Drexel Burnham Lambert, became RICO cases. This occurred despite alternative remedies under the securities laws and despite the fact that there has never been any accusation that organized syndicates were involved in any way with these cases.

The Giuliani cases also defied the very unusual rules of prosecutorial discretion that had been established and made formal by the Department of Justice in 1981. The Department of Justice Guidelines for RICO Prosecutions is a remarkably detailed, several-hundred-page set of instructions for all federal prosecutors setting out rigid, national rules of prosecutorial discretion. The provision states that unlike nearly all other cases, all RICO prosecutions by U.S. attorneys must be approved by the Department of Justice. These Guidelines were accepted as administratively binding policy, and as such both define the interpretation of RICO by the unitary executive branch of government and are intended to define improper uses of RICO.

The preface to the Guidelines makes clear that by 1981 law-enforcement officials understood that while RICO had a narrow purpose, it had

²⁰ *Id.* at 99-100 n.30.

²¹ *Id.* at 112.

been drafted in such a way as to possibly allow abusive prosecutions if ambitious U.S. attorneys were not kept in close check:

Despite the broad statutory language of RICO and the legislative intent that the statute “. . . shall be liberally construed to effectuate its remedial purpose,” it is the policy of the Criminal Division that RICO be selectively and uniformly used. It is the purpose of these guidelines to make it clear that not every case in which technically the elements of a RICO violation exist will result in the approval of a RICO charge.²²

On the contrary, the Guidelines stress that there must be a uniform understanding that the powerful weapon of RICO must only be applied to the rather narrow set of cases that Congress originally envisioned in its law against organized crime.

The Guidelines make it very clear that prosecutors are to err on the side of exercising discretion, not making headlines. “It is not the policy of the Criminal Division to approve ‘imaginative’ prosecutions under RICO which are far afield from the congressional purpose of the RICO statute,” the Guidelines warn.²³ “Stated another way, a RICO count which merely duplicates the elements of proof of a traditional Hobbs Act, Travel Act, mail fraud, wire fraud, gambling or controlled substances cases, will not be added to an indictment unless it serves some special RICO purpose as enumerated herein.”²⁴ That is, even for cases alleging traditional mobster activities including gambling and drugs, prosecutors are warned not automatically to bring RICO charges as well. How much less appropriate are cases alleging crimes that Congress would never have imagined could be RICO counts? The Guidelines emphasized that the purpose of RICO was quite narrow. “The purpose of the RICO statute,” the Guidelines said, “is ‘the elimination of the infiltration of organized crime and racketeering into legitimate organizations operating in interstate commerce.’ ”²⁵

Furthermore, the Guidelines stress that imaginative uses of RICO would surely lead to calls to repeal the provision. RICO provides the potential for abuse or overuse, the Guidelines acknowledged.²⁶ Injudicious use of the statute would reduce its impact in cases where it is truly warranted. For this reason, it is the policy of the Criminal Division that RICO be selectively and uniformly used.²⁷ In its section on the dangers of prosecutors using RICO to sue private parties for damages, the Guidelines noted that the department’s judicious and restrained use of RICO has been a significant factor in fending off attacks by groups who might like to see the statute’s provisions sharply diluted. As a result of the Giuliani prosecutions (which, like all RICO cases, had to be approved by the Department of Justice), there is reason to wonder whether these Guide-

22 CRIMINAL DIV., U.S. DEP’T OF JUSTICE, UNITED STATES ATTORNEYS’ MANUAL § 9-110.200 (1989) [hereinafter Guidelines].

23 *Id.*

24 *Id.*

25 *Id.* at § 9-110.100 (quoting S. REP. NO. 617, 91st Cong., 1st Sess. 76 (1969)).

26 *Id.* at § 9-110.200.

27 *Id.*

lines remain in effect or are in abeyance, gathering dust pending new direction from the Attorney General.

III. The RICO Monster Sickened on Wall Street

Despite the assurances in the Guidelines of "judicious" and "restrained" prosecutions for all crimes, beginning in the 1980s federal prosecutions are more accurately described as "injudicious" and "uninhibited," especially in the white-collar field. The most aggressive use of RICO was by Mr. Giuliani.

An early departure from traditional anti-mobster RICO cases came in 1984 in an extraordinarily complex case Mr. Giuliani brought against the wealthy oil trader, Marc Rich, who remains in Switzerland rather than defend himself from these charges in a U.S. criminal court. In 1983, Mr. Giuliani brought a fifty-one count indictment against Mr. Rich. The accusations were based on an alleged scheme to defraud the Internal Revenue Service whereby Marc Rich & Co. International purchased barrels of U.S. oil, then under Energy Department price controls, and resold the oil through a chain of oil resalers. The government claimed that this scheme allowed oil to be reclassified under the arcane Jimmy Carter-era price controls as uncontrolled oil that could be sold at higher prices.²⁸ Despite the underlying issue of the complex oil price controls, this was essentially a tax case. Mr. Giuliani charged that Mr. Rich and his colleagues schemed to defraud the IRS of a record \$50 million in unpaid taxes.

The main issue in the indictment was essentially whether income was attributable to a U.S. company or to a foreign holding company—a rather straightforward and commonplace issue in tax law usually brought as a civil, not criminal, case. Yet this was a criminal case raising tax questions that was not brought or styled primarily as a tax case. Instead, count one of the indictment was "the racketeering activity" and count two was "racketeering." There were also charges of mail and wire fraud. The Department of Justice Guidelines did not at the time expressly confine the practice of elevating tax cases to RICO cases—this would be expressly and narrowly limited in 1989 after later tax-as-RICO cases attracted unwelcome attention—but there was the strong suggestion that prosecutors should, at the very least, exercise special caution in linking criminal tax cases with such broad racketeering charges. Department supervisors, the Guidelines say, will not approve a proposed RICO indictment that contains as predicates mail fraud charges concerning federal tax evasion or related violations, unless the use of those charges is first cleared with the Criminal Section of the Tax Division.²⁹

The most notorious of Wall Street RICO cases arose from the three-year investigation by Mr. Giuliani of the investment bank Drexel Burnham Lambert and its leading employee, Michael Milken. The prosecutorial abuses under RICO that led to the settlement of charges by Drexel Burnham Lambert can only be understood after analyzing what

²⁸ See Goldsworth, *The Marc Rich Indictments: Evading Price Controls on U.S. Oil*, TAXES INT'L (London) (Nov. 1983).

²⁹ See *infra* Appendix A, at 1069-70.

became the test case, the investigation of a comparatively small securities house, Princeton/Newport Partners Ltd. On close inspection, the Princeton/Newport case was eerily similar to the Marc Rich case in being essentially a tax case elevated to a RICO case.

The core of the case against Princeton/Newport was that the firm had created fraudulent tax breaks by arranging false long-term capital gains and short-term capital losses. Despite this, the indictment in 1988 was not restricted to or even labelled as alleged tax violations. Instead, the indictment charged racketeering, conspiracy, mail fraud and wire fraud. The defendants argued in vain that at most this should be a civil tax case. Indeed, it is highly ironic and rather alarming that after bringing the indictment, the federal government informed partners of Princeton/Newport that the firm had in fact overpaid its federal taxes during the years covered by the indictment.

Why was Princeton/Newport brought as a RICO case instead of as a tax case? Defense lawyers made the very unusual and serious charge that Mr. Giuliani RICOed the firm not because of the heinousness of the alleged violations, but because RICO could be the rubber hose to bludgeon Princeton/Newport officials into testifying against bigger fish, including Drexel Burnham Lambert's Mr. Milken. Under this view, Mr. Giuliani's twin purposes in using RICO against Princeton/Newport were to force a plea bargain and to coerce testimony. In addition to Mr. Milken, Princeton/Newport traded with another investment banker whose case stymied Mr. Giuliani. In that case he had arrested three bankers on insider trading charges, and had one handcuffed in his Wall Street office, only to have to drop the case after he failed to gather enough evidence to go to trial. The three bankers included Robert Freeman, a banker at Goldman Sachs, who had traded with Princeton/Newport.

"The primary purpose [of the RICO prosecution] in this case is to coerce the testimony of the defendants against principals at Drexel Burnham Lambert and Goldman Sachs," said lawyers for Princeton/Newport officials.³⁰ One defense lawyer told *The Wall Street Journal* soon after the indictments that a prosecutor had told him that "we have no real interest" in Princeton/Newport, but that the firm "can help us with Drexel Burnham and others. . . . If you cooperate, fine. If you don't, we are going to roll right over you to get to where we want to go."³¹ Prosecutors deny these comments, although this was the perceived scenario that soon followed when Princeton/Newport was driven into liquidation before it could defend itself in court.

Part of what is so troubling about trying to use RICO to coerce testimony is that this can be akin to training a howitzer on a flea. The preface to the Guidelines recognizes this problem by warning against threatening RICO to coerce testimony or cooperation. "It should be noted that only in exceptional circumstances will approval be granted when RICO is

³⁰ Crovitz, *RICO's Broken Commandments*, Wall St. J., Jan. 26, 1989, at A14, col. 3.

³¹ Stewart & Hertzberg, *Five of Princeton/Newport's Partners Indicted in Racketeering, Fraud Case*, Wall St. J., Aug. 5, 1988, at A3, col. 2.

sought merely to serve some evidentiary purpose," the preface says.³² One concern is that rather than urge testimony against a target, a prosecutor threatening RICO may be just as likely to suborn perjury instead. This specter was also raised by Chicago U.S. Attorney Anton Valukas, who in the early days of the commodities investigation in early 1989 reportedly sent agents to the homes of traders threatening RICO if they did not agree to testify against their higher-up colleagues. Commodities traders recounted intimidating experiences. "You like your house, you like your car?" someone asks after knocking on the door at midnight. "Your wife likes her jewels? Well, they're ours now."³³

Using RICO to coerce testimony creates another serious problem in the context of alleged white-collar crimes. This is that the pre-trial asset forfeiture provisions work hardships on legitimate businesses that would not have nearly the same coercive effect on organized crime syndicates. Indeed, the hardships are so great that it is a reminder that Congress never intended these provisions to apply as against anyone but mobsters. Again, the Princeton/Newport case is instructive.

The possibility of pre-trial restraints on assets is clearly one of the most powerful tools for a prosecutor under RICO. This reverses the normal presumption of innocence and raises serious due process questions. The Guidelines say that pre-trial forfeiture of assets to guarantee the payment of later judgments may be appropriate where a defendant might otherwise begin to dispose of them or transfer them to conceal them from the government.³⁴ Clearly, the underlying purpose of this pre-trial remedy is that organized crime, with its foreign bases of operation, has traditionally been able not just to hide its assets but also to secretly transfer its assets outside the jurisdiction of U.S. courts. While this pre-trial procedure might make some sense for cases against a Mafia family or a corrupt foreign official indicted in U.S. courts, it has had perverse effects when used against legitimate businesses.

The pressure on Princeton/Newport became unbearable when Mr. Giuliani announced that he would seek to seize assets of the firm, but left the total amount to be bonded unclear. Indeed, the firm did not remain in business long enough to be able to defend itself in court. When Mr. Giuliani went after the firm's assets, the financial backers of the firm made the prudent calculation that they should quickly pull their funds out. These backers included McKinsey & Co., the management consultants, and the Harvard University endowment, which had been Princeton/Newport's two largest investors. Fund managers for these institutions asked themselves—and their lawyers—whether they could justify the risk that their funds might be frozen or seized. They were told that a RICO case is different from any other prosecution because investor funds could be attached.

Princeton/Newport officials warned that the hemorrhage of investment funds would be fatal to a business that depended on the flow of

³² See Guidelines, *supra* note 22 at § 9-110.200.

³³ *The Kinder, Gentler Hog Butcher*, Wall St. J., Jan. 26, 1989 at A14, col. 1 (editorial).

³⁴ See Guidelines *supra* note 2, at § 9-110.410.

funds from investors for its existence. Far from the Guideline's reference to disposing of assets before trial or beginning to "dispose of them or transfer them to conceal them from the government," Princeton/Newport pleaded with prosecutors to be able to do the opposite. It wanted to hold onto investor funds so that it could stay in business. It even posted a bond to guarantee that funds would be available for any possible judgment.

In the end, the threat of pre-trial seizures of assets drove investor funds out of Princeton/Newport and drove the firm into liquidation—before it was able to defend itself in court from the charges. The result is explained in an excerpt from Lewis Carroll's *Alice's Adventures in Wonderland*:

"Let the jury consider their verdict," the King said, for about the twentieth time that day.

"No, no!" said the Queen, "Sentence first—verdict afterward."

"Stuff and nonsense!" said Alice loudly. "The idea of having the sentence first!"

"Hold your tongue!" said the Queen, turning purple.

"I won't!" said Alice.

"Off with her head!" the Queen shouted at the top of her voice. Nobody moved.³⁵

In the case of Princeton/Newport, the "sentence first" was the death penalty.

Once Princeton/Newport officials got their day in court, another serious problem with RICO quickly became apparent. Defenders of RICO often say that it is modeled on the antitrust laws, but in at least one fundamental sense the two legal regimes are very different. The Supreme Court has interpreted the Sherman Act to require an "antitrust injury" even though the statute itself does not expressly include this requirement.³⁶ Yet in *Sedima* and ever since, the courts have not required any specific "racketeering injury." Such an injury is not expressly required by the language of RICO, and the Princeton/Newport trial is a perfect example of the harm done by its failure to require prosecutors who bring a RICO case to allege and prove a racketeering injury—or, for that matter, an injury of any kind.

The conviction this past summer of several former Princeton/Newport officials on RICO charges was itself the culmination of an extraordinary strategy by the U.S. Attorney's office. The underlying crime alleged was a violation of the tax code by some year-end tax-driven trades by the firm. The defendants argued that these tax-straddle trades were routine. What is most striking from reading the several thousand pages of the trial transcript is how very little discussion there was of the tax code, and how many rather vague accusations were made by the prosecution that tax-motivated trades are somehow inherently suspicious and criminal. Listen to the prosecutor in the case summarizing his case to the jury: "You don't need a fancy tax law expert because common sense tells you

³⁵ L. CARROLL, *ALICE'S ADVENTURES IN WONDERLAND* 160-61 (M. Gardner ed. 1960).

³⁶ *Brunswick Corp. v. Pueblo Bowl-O-Mat*, 429 U.S. 477 (1977).

it's fraudulent, it's phony. . . . Doesn't it feel wrong? Doesn't it sound sleazy? If it sounds sleazy it's because it is sleazy. Your common sense tells you that."³⁷

But it turns out that the tax issues were actually rather complex, far more complex than the jury ever learned. Boris Bittker, the emeritus Yale Law tax expert, was prepared to testify that these trades were not criminal and indeed were perfectly routine trades locking in recognition of gains and losses. After the prosecution objected, however, he was not allowed to testify. They thought it might confuse the jury about the law. In other words, RICO means never having to find substantive criminal offenses any more specific than "fraud" or "sleaze."

In an article in *The Wall Street Journal*, I likened the Princeton/Newport prosecution to a scene from the classic Western film, "Treasure of the Sierra Madre." Humphrey Bogart and his pals are guarding some gold when they're surrounded by Mexican bandits. One of the bandits says: "We are the *Federales*. You know, the mounted police." Bogart says: "If you're the police, where are your badges?" The bandit replies: "Badges? We ain't got no badges. We don't need no badges. I don't have to show you any stinkin' badges."³⁸

Now we have a federal prosecutor in the Princeton/Newport case who assures the jurors that they don't need any "fancy tax law expert because common sense tells you it's fraudulent." In other words: "Tax laws? We ain't got no tax laws. We don't have to show you any stinkin' tax laws."

Or, as R.W. Grant, the libertarian poet, wrote in a similar context: "The rule of law, in complex times,/ Has proved itself deficient./ We much prefer the rule of men!/ It's vastly more efficient!"³⁹

In the end, neither the jury nor the federal district judge who heard the case were impressed by the RICO charges. The government had sought some \$21 million in assets from the defendants. When the judge asked the jury for their figure, they vastly reduced this figure. U.S. District Judge Robert L. Carter ordered forfeitures of only \$1.6 million. Even more significantly, despite the convictions, Judge Carter refused to order any punishment for any of the defendants on the RICO charges. Judge Carter dismissed the forfeitures sought by the government by citing the Eighth Amendment prohibition against excessive fines. Comparing the "harshness of the penalty and the gravity of the offense," he concluded that the benefits the defendants received were greatly disproportionate to the penalty.⁴⁰ He noted that he had "not been able to find any case in which there has been any forfeiture ordered in a conviction for tax fraud," and also cited the Justice Department's RICO guidelines as a factor in his decision.⁴¹ Thus, this extraordinary RICO case created

37 Wall St. J., June 21, 1989, at B11, col. 1.

38 See Crovitz, *RICO Needs No Stinkin' Badges*, Wall St. J., Oct. 4, 1989, at A30, col. 3.

39 R.W. GRANT, *THE INCREDIBLE BREAD MACHINE* (1966), quoted in WORLD RESEARCH, INC., *CAMPUS STUDIES INST. DIV., THE INCREDIBLE BREAD MACHINE* 174 (1974).

40 United States v. Regan, 726 F. Supp. 447, 456-57 (S.D.N.Y. 1989) (citing *Solem v. Helm*, 463 U.S. 277, 292 (1983)).

41 *Id.* at 457.

much smoke but no fire. On the other hand, it did result in some reforms from the Justice Department.

Indeed, there is now some chance that there will be no more RICO cases quite like Princeton/Newport. The Department of Justice now has issued two amendments related to RICO for insertion into the Guidelines for U.S. Attorneys. Although some prosecutors have downplayed their importance, it seems to me that these guidelines are nothing less than an unprecedented departmental *mea culpa* for RICO abuses.

The first to become publicly known was from the Tax Division of the Justice Department. This memorandum, reproduced as Appendix A, generally prohibits U.S. Attorneys from bringing RICO or mail fraud charges based on alleged tax violations. The memorandum states that except under the "exceptional circumstances" of a tax shelter that victimizes third parties, prosecutors abuse their power when they bring RICO or mail fraud charges masquerading as tax charges. The memorandum states, "It is the position of the Tax Division that Congress intended that tax crimes be charged as tax crimes," and not under some other heading or criminal code.⁴² "Tax offenses are not predicates for RICO offenses—a deliberate congressional decision—and charging a tax offense as a mail fraud charge could be viewed as circumventing congressional intent."⁴³

It is worth noting that the rationale for this amendment to the U.S. Attorneys Manual is the same as the reason that limits to fewer than 1,500 the annual number of federal criminal tax cases. This is because tax law is so complex and the potential for prosecutorial abuse is so great—who has never made some technical error filling out a tax form?—that some central authority in the Justice Department must closely supervise which cases are brought and why. This explains why, almost unique among all cases, U.S. Attorneys have routinely submitted proposed criminal tax indictment, to the Tax Division at Justice for pre-filing approval. This system reportedly broke down during Mr. Giuliani's tenure as U.S. Attorney, and his cases proved that the vague RICO and mail fraud laws give prosecutors too much discretion to bring quasi-tax cases.

The second amendment to the U.S. Attorneys Manual was made by the Criminal Division of the Justice Department. This amendment, reprinted as Appendix B, limits approval by the division for U.S. Attorneys seeking to bring a motion for a temporary restraining order in connection with a case involving RICO forfeiture. It noted that "[s]uch order can have a wide-ranging impact on third parties who do business with the defendants, including clients, vendors, banks, investors, creditors, dependents, and others."⁴⁴ It made an unusual reference to public criticism of some abuses by the prosecutors. "Some highly publicized cases involving RICO temporary restraining orders (TROs) have been the subject of considerable criticism in the press, because of a perception that pre-trial freezing of assets is tantamount to a seizure of property without

⁴² See *infra* Appendix A, at 1069-70.

⁴³ *Id.* at 720.

⁴⁴ See *infra* Appendix B, at 1071-72.

due process.”⁴⁵ It told prosecutors not to seek forfeitures if there are “less intrusive” alternatives, such as bonds, and in any case not to seek forfeitures “disproportionate to the defendant’s crime.”⁴⁶

These amendments to the U.S. Attorneys Manual came too late for officials at Drexel Burnham Lambert, who felt forced to roll over even before the Princeton/Newport case went to trial. Mr. Giuliani threatened to bring a RICO indictment against the firm, with all the pre-trial penalties that drove Princeton/Newport into liquidation. Fight the charges and risk going out of business? Or try to settle on lesser charges? This was the \$650 million question for the board of directors of Drexel Burnham Lambert, which decided that this amount in settlement of all the charges was a fair price to pay to avoid being RICOed. The board voted to agree to plead guilty to six charges, and convinced the prosecutors to agree to let the firm make a very unusual stipulation in its settlement. Drexel Burnham Lambert insisted on the right to plead guilty to charges “which the company is not in a position to dispute.”⁴⁷ The reason the firm could not dispute the charges did not have anything to do with the availability of evidence or able legal counsel. Instead, it is the very threat of RICO that made a defense of a possible RICO charge impossible. RICO clearly coerced the plea.

This coercion is not only offensive to notions of justice and due process, but also appears to violate one of the most unambiguous sections of the RICO Guidelines. “Inclusion of a RICO count in an indictment solely or even primarily to create a bargaining tool for later plea negotiations on lesser counts,” the Guidelines say, “would not be appropriate and would violate the *Principles of Federal Prosecution*.”⁴⁸

Next came the ninety-eight count indictment of Michael Milken and others. The indictment was even more RICO-based than the earlier Marc Rich indictment, which at least had some counts based on the alleged underlying violations of the tax code. In the case of Mr. Milken, the ninety-eight counts were presented purely as a racketeering case. Drexel Burnham Lambert was repeatedly referred to as a “racketeering enterprise.” The only references to the alleged underlying violations of the securities laws are relegated to parenthetical references to sections of the criminal code. Whether there will ever be a superseding indictment clarifying the securities and other charges involved, or whether this case goes to trial or whether Mr. Milken and the others will also settle, blaming the coercive aspects of RICO, at this writing remain to be seen.

There is something distinctly dissatisfying about pre-trial settlements under these circumstances. Drexel Burnham Lambert has a very good argument that it settled only because of the threat of a RICO lawsuit that on the precedent of Princeton/Newport could mean that the firm would not last long enough to defend itself in court. On the other hand, Mr. Giuliani can argue that his years of investigation of the firm

45 *Id.* at 723.

46 *Id.* at 724.

47 *Giuliani's Legacy*, Wall St. J., Oct. 25, 1989 at A18, col. 1 (editorial).

48 See Guidelines *supra* note 22, at § 9-110.310.

finally paid off, and that the firm chose to settle in the face of the evidence he had gathered.

The irresolution of the case is compounded by the fact that the Drexel Burnham Lambert investigation was in the headlines for several years, and led to congressional investigations and repeated citations by the Securities and Exchange Commission as justification for huge new budget increases. Criminal trials, with their convictions or their acquittals, are supposed to be the final conclusions to these kinds of accusations of serious offenses. The troubling conclusion here is that no one may ever know whether Drexel Burnham Lambert in fact did anything wrong, or happened to get caught up in an essentially political persecution. There were many special interests—from entrenched corporate managers to competing investment bankers—that did not hide their hostility to the firm's pioneering work in high-yield "junk" bonds. Thus, to the degree that RICO leads to ambiguous settlements by white-collar defendants, both the defendants and society generally are robbed of the liberating finality of a trial.

IV. Civil RICO Roams Wall Street and Main Street

As troubling as the criminal use of RICO has become, RICO's use as a rubber hose in the civil context perhaps affects more people, and poses an equally substantial threat to civil rights. RICO offers the lure of treble damages plus lawyers fees to plaintiffs who bring private actions for damages against private defendants. Despite the fact that RICO is a title within a broader law on *criminal* cases, by now the vast majority of RICO cases are purely private, civil cases. Ironically, civil RICO was not even part of the law as passed by the Senate. Only the House version included civil RICO, which was added to RICO without even a conference on the bill. This struck the Second Circuit Court of Appeals as highly significant:

The legislative history of the Organized Crime Control Act of 1970 gives little hint of the intended scope of private action under civil RICO. . . . The decision to add a civil private damages provision was made by a House subcommittee at the behest of Representative Sam Steiger and the American Bar Association. The addition was not considered an important one, a remarkable fact which in itself indicates that Congress did not intend the section to have the extraordinary impact claimed for it. Indeed, when the Judiciary Committee initially introduced the amended bill, it did not even announce to the House that it had made the addition.⁴⁹

The court noted that there were only three statements regarding civil RICO made on the floor of the House, one of which was simply to claim that the treble damages provision was "another example of the antitrust remedy going adapted for use against organized criminality."⁵⁰ Thus, with almost no legislative debate or comment, RICO was extended as an

⁴⁹ Sedima, S.P.R.L. v. Imrex Co., 741 F.2d 482, 489-90 (2d Cir. 1984), *rev'd*, 473 U.S. 479 (1985).

⁵⁰ *Id.* at 490.

afterthought to cases between private citizens as a way to encourage private suits against the Mob.

That civil suits were intended to be narrowly limited to cases in which organized syndicates caused identifiable damages to private individuals is clear from the fact that this provision was basically a dead letter for the first decade of the statute. The ABA found that there was one federal court decision on civil RICO by 1972, only one other case by 1975 and only a total of nine civil RICO decisions by 1980. But by the 1985 publication date of the ABA report, there were some 300 such decisions.⁵¹ By now, the number is in the thousands, with many more in the pipeline. There are even publications aimed at keeping lawyers up to date with new uses for RICO. One, the "Civil RICO Report" offers lawyers weekly updates on how to use the law for the price of \$495 a year.⁵² In addition to the lure of treble damages and lawyers fees if the plaintiffs can label the defendants as "racketeers," this of course greatly enhances the settlement value of even the most frivolous case.

The range of civil RICO cases is as wide as those activities that can allegedly amount to two predicates of "fraud" using the mails or the wires. Here is a list of legitimate businesses that have been sued under RICO to show the range of "racketeers":

AETNA Casualty and Surety, A.H. Robbins, Allstate Insurance, American Broadcasting Company, Arthur Anderson, Chase Manhattan Bank, Citibank, Coopers and Lybrand, Dean Witter Reynolds, Exxon, Ford, General Motors, E.F. Hutton, Lehman Bros. Kuhn Loeb, Loeb Rhoades & Co., Merrill Lynch, Miller Brewing, Morgan Stanley, Pantry Pride, Peat Marwick & Mitchell, Price Waterhouse, Prudential Life Insurance, Shearson/American Express, State Farm Fire and Casualty, Texaco, and Touche Ross.⁵³

There have been landlord-tenant, divorce and will cases brought as RICO cases. More incredibly, there have been successful RICO suits against anti-abortion demonstrators and even a RICO suit against a weekly newspaper in upstate New York for daring to report and editorialize on anti-abortion demonstrations. Does RICO pre-empt the First Amendment?

V. The RICO Mindset

There is a deeper argument under the surface of the RICO debate. Very few commentators believe that Congress intended anything like the broad sweep of criminal targets and civil defendants now forced to confront the statute. The nine Supreme Court Justices in *Sedima* were unanimous that RICO was by 1985 already being applied in ways never intended by Congress, but nine Justices held that only Congress could correct the abuses under the statute. Justice Antonin Scalia, joined by

51 See *Civil RICO Task Force Report*, *supra* note 3, at 55.

52 Civ. RICO Rep. (BNA) (1985).

53 THE RICO RACKET, *supra* note 2, at 27.

three other Justices, suggested in *H.J. Inc. v. Northwestern Bell Telephone Co.*,⁵⁴ that RICO may well be unconstitutionally vague. He wrote:

No constitutional challenge to this law has been raised in the present case, and so that issue is not before us. That the highest Court in the land has been unable to derive from this statute anything more than today's meager guidance bodes ill for the day when that challenge is presented.⁵⁵

Why, then, has there been such little progress made toward legislative reform of RICO? Various proposals have been made, including one requiring a criminal conviction under RICO before the filing of a civil suit, which would reduce the number of civil actions dramatically. Congress has not voted on any reform proposals, despite intense lobbying.

One possible explanation is that RICO fits nicely into the liability-broadening, deep-pocket picking trend in American law of the past twenty-five years. The crisis in tort law has made common law concepts that were familiar to the last generation totally archaic to this generation. It is now widely understood that liability has widened due to changes such as the relaxation of the fault requirement and more liberal assessment of punitive damages.⁵⁶ The doctrine of "enterprise liability" has held corporate defendants liable even where fault is hard and perhaps impossible to establish. Punitive damages one-hundred times the amount of the compensatory damages are awarded with some regularity. So part of the allure of RICO, especially civil RICO, may be the same soak-the-rich mentality that has altered the landscape of tort law generally. The fact that a Ralph Nader group has gone to the length of picketing a Washington, D.C., law firm that had lobbied for RICO reform is a sign that the political stakes here are steep indeed.

There is also what might be called the moral relativism defense of RICO, which equates the activities of organized criminals with the activities of legitimate businesses and is unable to differentiate between the two. Under this view, the rigorous penalties of RICO are just as applicable against an investment banker or accountant as against the head of a Mafia family that runs drugs and commits murder. Indeed, defenders of the RICO statute make this very argument. Robert Blakey, a Notre Dame Law School professor who was an aide to Senator McClellan during the drafting of RICO, defends the broad use of RICO under this very reasoning. "Mike Milken made \$550 million in one year," Prof. Blakey said in a *Forbes* magazine interview. "Nobody else made that much in the history of the country except Al Capone. What did he do? He cheated. What was Milken doing? He cheated. Of course, Capone stole and killed to do it."⁵⁷ Elsewhere, Professor Blakey has said:

Read the language [of RICO]. The language says 'any person.' There's nothing about any person who happens to be a member of the mob, or any persona whose name ends in a vowel. It says any person. Stop and

54 109 S. Ct. 2893 (1989).

55 *Id.* at 2909.

56 See generally P. HUBER, *LIABILITY: THE LEGAL REVOLUTION AND ITS CONSEQUENCES* (1988).

57 Queenan, G. *Robert Blakey versus Michael Milken*, *Forbes*, May 1, 1989, at 57, 60.

think about it for a minute. It would be obscene if it were otherwise. The statute doesn't apply to blue-collar people only, or no-collar people only. It applies to everybody.⁵⁸

But in fact, of course, there are huge differences between the Mafia and, say, Drexel Burnham Lambert. For one thing, the Mafia was set up as a criminal enterprise. Drexel Burnham Lambert is a registered brokerage. The Mafia makes money by committing crimes. Drexel Burnham Lambert makes money by attracting clients. The Mafia gets involved with legitimate businesses only as a deviation from its norm. If Drexel Burnham Lambert broke the law, it would have been a deviation from its usual pattern. Moreover, the kinds of activities that RICO envisioned as predicates—murder, loansharking, gambling, extortion—are well-understood crimes and there is very little doubt about the existence of a victim. Under the indictment of Drexel Burnham Lambert, the alleged fraud has the very curious feature that very few people have come forward to say that they were harmed.

It is one of the great virtues of the American system of justice that most legal abuses are committed in violation of the law, not in the name of the law. The Racketeer Influenced and Corrupt Organizations law is a leading exception to the rule. In the case of RICO, grotesque abuses of our system of justice are paradoxically done in the name of this law.

It is doubtful that Congress would ever pass a criminal law that equates criminal syndicates with legitimate businesses and private citizens. Certainly this is not what Congress envisioned in 1970 when it passed RICO. The question now is whether Congress will admit that its faulty drafting has led to untold injustices. RICO has led to coerced guilty pleas, which amount to legalized extortion. Out-of-court payments to settle civil suits are little more than classic shakedowns. Indeed, it is no exaggeration to conclude that until Congress finally repeals this outrageous statute or the Supreme Court invalidates it, RICO will remain the real racket.

58 Nightline: RICO (ABC television broadcast, Apr. 12, 1989).

APPENDIX A

TO: Holders of United States Attorneys' Manual Title 6
 FROM: United States Attorneys' Manual Staff
 Executive Office for United States Attorneys
 Shirley D. Peterson
 Assistant Attorney General
 Tax Division

RE: *Charging the Filing or Causing the Filing of False Income Tax Returns as Mail-Fraud and/or as Mail Fraud Predicates to a RICO Charge*

NOTE: 1. This is issued pursuant to USAM 1-1.550.
 2. Distribute to Holders of Title 6.
 3. Insert at end of USAM Title 6.

AFFECTS: USAM 6-4.211(1)

PURPOSE: This bluesheet implements prosecutive policy concerning the use of mail fraud charges and mail fraud predicates for RICO where the filing of false tax returns or forms is involved.

The following supplements 6-4.211 Tax Division Jurisdiction with a new subsection 6-4.211(1) Filing False Tax Returns: Mail Fraud Charges or Mail Fraud Predicates for RICO.

The authorization of the Tax Division is required before charging mail fraud counts either independently or as predicate acts to a RICO charge: (1) when the only mailing charged is a tax return or other internal revenue form or document; or (2) when the mailing charged is a mailing used to promote or facilitate a scheme which is essentially only a tax fraud scheme (e.g., a tax shelter).¹ Such authorization will be granted only in exceptional circumstances as explained below.

The filing of a false tax return, which almost invariably involves a mailing, is a tax crime chargeable under 26 U.S.C. 7206(1) (if the violator is the taxpayer) or 25 U.S.C. 7206(2) (if the violator is, for example, a tax return preparer or tax shelter promoter). It is the position of the Tax Division that Congress intended that tax crimes be charged as tax crimes and that the specific criminal law provisions of the Internal Revenue Code should form the focus of prosecutions when essentially tax law violation motives are involved, even though other crimes may technically have been committed. See, *United States v. Henderson*, 386 F. Supp. 1048, 1052-53 (S.D.N.Y. 1971).²

Under certain narrowly defined circumstances, however, a mail fraud prosecution predicated on a mailing of an internal revenue form or document, or where the scheme involved is essentially a tax fraud scheme, might be appropriate in addition to, but never in lieu of, applicable substantive tax charges. See, *United States v. Mangan*, 575 F.2d 32, 48-49 (2d

¹ A scheme does not fall in the latter category if it is *designed* to defraud individuals or to defraud the government in a non-revenue collecting capacity.

² The Ninth Circuit in *United States v. Miller*, 545 F.2d 1204, 1216 (9th Cir. 1976) *cert denied*, 430 U.S. 930 (1977) in footnote 17 stated a contrary position, but did not analyze the issue as it was not squarely presented. The case involved corporate diversion and possible fraud on creditors as well as tax evasion.

Cir. 1978) (where the defendant filed false refund claims on behalf of others, thereby acting more like a thief in the traditional sense). Such a situation could arise in a tax shelter or other tax fraud case, when individuals, through no deliberate fault of their own, were demonstrably victimized as a result of a defendant's fraudulent scheme and use of a mail fraud charge is necessary to achieve some legitimate, practical purpose like securing restitution for the individual victims. The fact that a defendant committed conduct which independently victimized individuals is to be reflected in the mail fraud allegations in the indictment. Mail fraud charges could also be used in a tax fraud case when the government was also victimized in a non-revenue collecting capacity. See, *e.g.*, *United States v. Busher*, 817 F.2d 1409, 1412 (9th Cir. 1987) (case involving primarily false contract claims). However, to the extent victimization of third parties constitutes an exception to the general rule, the evidence must demonstrate direct, substantial victimization as opposed to a general or theoretical harm to a general class of victims.

Normally, in a tax shelter case, the mere imposition of interest and penalties on the investors will not constitute sufficient victimization to warrant the use of mail fraud charges in addition to tax charges. However, each individual case will be reviewed on its merits to determine whether the degree of culpability of the individual investors is such as to treat them more as victims than participants in the particular scheme. Among the factors to consider are the existence of bona fide pending civil suits against the promoters by the investors, the nature and degree of misrepresentations made to the investors, and the degree of independent losses beyond the tax liability.

A similar policy will be followed with respect to the filing of RICO charges predicated on mail fraud charges which in turn involve essentially only a tax fraud scheme. Tax offenses are not predicates for RICO offenses—a deliberate Congressional decision—and charging a tax offense as a mail fraud charge could be viewed as circumventing Congressional intent unless unique circumstances justifying the use of a mail fraud charge are present.

However, once a decision has been made by the Tax Division to authorize mail fraud charges, the decision whether to authorize a RICO charge in turn based on these mail fraud charges is one for the Criminal Division to make.

For a determination as to whether a mail fraud charge predicated on the mailing of internal revenue forms or documents is appropriate, the Tax Division should be consulted early in the investigation rather than waiting until a last minute decision is needed.

APPENDIX B

TO: Holders of United States Attorneys' Manual Title 9
FROM: United States Attorneys' Manual Staff
Edward S.G. Dennis, Jr.
Assistant Attorney General
Criminal Division
RE: Temporary Restraining Orders Under 18 U.S.C.
§ 1963(d)
AFFECTS: USAM 9-110.300, et seq.
PURPOSE: This bluesheet implements new policy regarding the requirement of approval by the Organized Crime and Racketeering Section prior to filing a motion for a temporary restraining order under 18 U.S.C. § 1963(d) in connection with a case involving RICO forfeiture.

The following should be added after USAM 9-110.413: 9-110.414:
Temporary Restraining Orders

Under 18 U.S.C. § 1963(d), the government may seek a temporary restraining order (TRO) upon the filing of a RICO indictment, in order to preserve all forfeitable assets until the trial is completed and judgment entered. Such orders can have a wide-ranging impact on third parties who do business with the defendants, including clients, vendors, banks, investors, creditors, dependents, and others. Some highly publicized cases involving RICO TROs have been the subject of considerable criticism in the press, because of a perception that pre-trial freezing of assets is tantamount to a seizure of property without due process. In order to ensure that the rights of all interested parties are protected, the Criminal Division has instituted the following requirements to control the use of TROs in RICO prosecutions. (It should be noted that these requirements are in addition to any other existing requirements, such as review by the Asset Forfeiture Office.):

1. As part of the approval process for RICO prosecutions, the prosecutor must submit any proposed forfeiture TRO for review by the Organized Crime and Racketeering Section. The prosecutor must show that less-intrusive remedies (such as bonds) are not likely to preserve the assets for forfeiture in the event of a conviction.
2. In seeking approval of a TRO, the prosecutor must articulate any anticipated impact that forfeiture and the TRO would have on innocent third parties, balanced against the government's need to preserve the assets.
3. In deciding whether forfeiture (and, hence, a TRO) is appropriate, the Section will consider the nature and severity of the offense; the government's policy is not to seek the fullest forfeiture permissible under the law where that forfeiture would be disproportionate to the defendant's crime.
4. When a RICO TRO is being sought, the prosecutor is required, at the earliest appropriate time, to state publicly that the government's request for a TRO, and eventual forfeiture, is made in full recognition of the rights of third parties—that is, in requesting the TRO, the government will not seek to disrupt the normal, legitimate business activities of the defendant; will not seek through use of the relation-back

doctrine to take from third parties assets legitimately transferred to them; will not seek to vitiate legitimate business transactions occurring between the defendant and third parties; and will, in all other respects, assist the court in ensuring that the rights of third parties are protected, through proceedings under 18 U.S.C. § 1963(1) and otherwise.

The Division expects that the prosecutor will announce these principles either at the time the indictment is returned or, at the latest, at the first proceeding before the court concerning the TRO.