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MLSMK Investment Co.: Civil RICO Liability After the Private Securities Litigation Reform Act and Central Bank

Matthew P. Thomas*

I. INTRODUCTION

In 1970, the United States Congress passed the Racketeer Influenced and Corrupt Organizations Act (RICO) in an attempt to “eradicate” organized crime. In service of that goal, it sought to provide “enhanced sanctions and new remedies to deal with the unlawful activities of those engaged in organized crime.” Along with RICO’s criminal penalties, the Act provides for considerable civil remedies, including treble damages. The appeal of treble damages caused many plaintiffs to turn ordinary civil actions into RICO claims. Some courts became alarmed at the “extraordinary, if not outrageous” ways in which RICO was being invoked and sought to limit its reach. The Supreme Court rebuffed those attempts at restriction. With a judicial fix ruled out, the legislature moved to limit the applicability of RICO in civil cases when it passed section 107 of the Private Securities Litigation Reform Act (PSLRA) (The RICO Amendment).

This Comment will look at the Second Circuit’s restrictive analysis on the RICO Amendment’s bar against RICO claims in MLMK Investment Co. v. J.P. Morgan Chase & Co., a case stemming from Bernie

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3. Id.


5. 18 U.S.C. § 1964(c).


8. Id. at 484.


10. Pub. L. No. 104-67, § 107 (1995) (amending 18 U.S.C. § 1964(c) to provide that “no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of section 1962”).

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Madoff's Ponzi scheme. Primarily, the court sought to determine whether the "RICO Amendment bars all RICO claims 'that would have been actionable as fraud in the purchase or sale of securities,' or only RICO claims in cases where that plaintiff could have asserted a fraud claim against the named defendant." The Second Circuit held that section 107 of the PSLRA precludes a plaintiff from bringing a civil RICO claim premised upon predicate acts of securities fraud even when the plaintiff could not bring a private securities law claim against the same defendant.

This Comment will argue that the rule announced in MLSMK is correct on both legal and public policy grounds, despite what its critics have argued. The Comment proceeds in three parts. Part II examines the background of civil RICO liability, from the passage of RICO in 1970 through the passage of section 107 of the PSLRA, looking at legislative purpose, relevant case law, and attempted changes. Part III explores the Second Circuit's decision MLSMK, an article about the case by Michael Buscher, and an article about the underlying issue by Eliza Clark Riffe. Part III will first look at the relevant facts, the Second Circuit's holding, and the court's reasoning in MLSMK. Then it will look at both the Buscher and Riffe article, outlining each author's legal and policy arguments. Part IV analyzes the legal and policy arguments underpinning the holding of MLSMK, arguing that both are sound, contrary to critical treatment. Part V summarily concludes.

II. BACKGROUND

A. RICO Passed as a Broad Anti-Organized Crime Measure

Congress' stated goal in passing the Organized Crime Control Act of 1970, which created RICO, was the "eradication of organized crime." During its deliberations, Congress found that, among other things, organized crime in the United States "weaken[s] the stability

12. Id. at 274 (citations omitted).
13. Id. at 280.
15. See infra Part II.
16. See infra Part III.
17. See infra Part IV.
18. See infra Part V.
of the Nation's economic system, harm[s] innocent investors and competing organizations, interfere[s] with free competition, . . . threaten[s] the domestic security, and undermine[s] the general welfare of the Nation and its citizens." Congress further stated that organized crime continued to grow, unabated by law enforcement, because of deficiencies in the evidence gathering process and a lack of effective remedies "to bear on the unlawful activities of those engaged in organized crime." The purpose of the law was to close those deficits. In order to expand the remedies available to prosecutors in their fight against organized crime, Congress added civil remedies that included treble damages. The version of the bill that originally passed the Senate did not include the treble damages provision; the only civil remedy it provided for was injunctive relief. However, treble damages were included in the final bill after supporters argued that it would increase the effectiveness of RICO's provisions by adding another avenue from which organized crime could be attacked. Despite the advantages of the treble damage provisions, three members on the House Judiciary Committee opposed its inclusion, based on the prescient fear that it would be used to go after legitimate businesses, not just organized crime. After clearing the committee, the bill passed both the House of Representatives and the Senate with little trouble.

B. After the Passage of RICO, Civil RICO Cases Became Dominated by Cases Against Legitimate Businesses, sparking concern

The opportunity for the treble damages promised by civil RICO cases went largely unnoticed during the law's first decade. In the first eleven years of the law, there were only eighteen published opinions dealing with civil RICO cases; in the next three years that number would increase to over one hundred. By the mid-1980s, as a result of the potential for a large payday, a so-called "RICO Bar"

20. Id.
21. Id.
22. Id.
24. Id. at 487; see United States v. Turkette, 452 U.S. 576, 585 (1981) (explaining that civil remedies can be effective against organized crime by being one more tool for the public to use to "divest" the organization of its "ill-gotten gains").
26. Id. at 488.
29. Sedima, 741 F.2d at 486.
formed that “specialize[d] in bringing or defending RICO claims.”

The “RICO Bar” usually wielded RICO claims as a tool to obtain a settlement, lest the defendant risk being labeled as a racketeer and, even worse, having to pay the onerous treble damages. Civil RICO cases were not targeting organized crime anymore but, rather, deep-pocketed companies like “American Express Company, E.F. Hutton & Co., Lloyd’s of London, Bear Stearns & Co., and Merrill Lynch.”

This explosion of civil RICO cases, instead of securities fraud claims, was likely due to the “RICO Bar” realizing that alleging a RICO violation allowed plaintiffs to not only receive treble damages instead of actual damages, but it also allowed plaintiffs to sidestep the standing limitations imposed on securities fraud suits.

In response to this apparent gaming of the system, the Second Circuit in *Sedima v. Imrex Co.* attempted to limit recovery of treble damages to instances when the defendant had already been criminally convicted of either a predicate act or a RICO violation. Under the Second Circuit’s view, to bring a civil RICO case, the plaintiff must first wait for a successful criminal conviction of the predicate act that gives rise to a RICO charge. The court, after noting that 18 U.S.C. § 1964(c) was modeled after section 4 of the Clayton Act, reasoned that, because the Clayton Act says: “injured . . . by reason of anything forbidden in the antitrust laws,” while § 1964(c) says: “injured . . . by reason of a violation of section 1962,” Congress intended to impose a conviction requirement to § 1964(c) where none exists in section 4 of the Clayton Act.

The court read the language of § 1964(c) to mean that only criminal conduct would be punished, implying that a plaintiff would have to prove the conduct beyond a reasonable doubt at trial. In order to avoid confusion for juries wrestling with different burdens of proof for

30. *Id.* at 486–87.
31. *Id.*
32. *Id.* at 487.
33. Note, *supra* note 28, at 1115–16. In order to establish standing for a Rule 10b-5 violation, the potential plaintiff must have been the actual purchaser or seller of the security. *See* Blue Chip Stamps v. Manor Drug Store, 421 U.S. 723 (1975).
34. *Sedima*, 741 F.2d at 503.
35. *Id.* at 502.
40. *Id.* at 502–03.
different claims in a civil trial, the court determined that Congress "expected" civil RICO cases to require a prior criminal conviction.41 The Second Circuit tried to further limit recovery by imposing a standing requirement on the plaintiff of having suffered a "racketeering injury."42 The court defined "racketeering injury" as being the type of injury contemplated by the passage of RICO even though it rejected a need to tie a violation to organized crime earlier in the case.43 The court based this definition on its interpretation of the Clayton Act as requiring an "antitrust injury."44 On appeal, the Supreme Court reversed this ruling.45

The Supreme Court easily struck down the Second Circuit's conviction requirement.46 The Court first explained that the "term 'violation' does not imply a criminal conviction" under RICO.47 The term has been interpreted to mean "failure to adhere to legal requirements" in other sections of the statute rather than requiring a formal conviction.48 Further, the only reference to a conviction requirement in RICO's legislative history is an objection that the treble-damages provision is too broad because there is no conviction requirement.49 The Supreme Court also struck down the "racketeering injury" requirement imposed by the Second Circuit because interpreting "racketeering injury" consistently with the statutory language would make the requirement superfluous.50 The Court reasoned that any plaintiff who wished to recover for a RICO violation would have to show that he was injured in his business or property by "(1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity."51 This means that any recoverable injury is necessarily a "racketeering injury."52

41. Id. at 503.
42. Id. at 498.
43. Id. at 495–96 ("RICO was not enacted merely because criminals break laws, but because mobsters ... cause systemic harm to competition and the market, and thereby injure investors and competitors. It was to help solve this problem that Congress added RICO to the arsenal of weapons used to fight organized crime."); see id. at 492 (rejecting the organized crime requirement).
44. Sedima, 741 F.2d at 494–95.
46. Id. at 489–90.
47. Id. at 489.
48. Id.
49. Id. at 489–90 (quoting 116 Cong. Rec. 35,342 (1970)).
50. Sedima, 473 U.S. at 494–95.
51. Id. at 496.
52. Id.
Sedima established that RICO is to be read broadly regardless of the consequences.53 The Court quoted from the Organized Crime Control Act of 1970, saying that Congress expressly wanted RICO to "'be liberally construed to effectuate its remedial purposes.'"54 Instead of sharing the Second Circuit's fear of the "extraordinary, if not outrageous"55 application of civil RICO, the Supreme Court said that when it passed the legislation, Congress wanted to "reach both 'legitimate' and 'illegitimate' enterprises."56 The Court did concede that most private actions under RICO were being brought against legitimate businesses rather than against mobsters, but said that "this defect . . . is inherent in the statute as written, and its correction must lie with Congress."57

C. After Sedima, the Supreme Court Began a Move to Limit RICO

Despite the Supreme Court's proclamation in Sedima, seven years later in Holmes v. Securities Investor Protection Corp.,58 the Supreme Court imposed its own limit to civil RICO cases by applying common law proximate cause requirements to such cases.59 The Court based this application of a common law proximate cause requirements on the shared language between § 1964(c), section 4 of the Clayton Act, and section 7 of the Sherman Act.60 Section 1964(c) states: "Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damage he sustains and the cost of the suit, including reasonable attorney's fee."61 Section 4 of the Clayton Act similarly states: "[A]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any [appropriate United States district court], and shall recover threefold the damages by him sustained, and the cost of the suit, including a reasonable attorney's fee."62

54. Sedima, 473 U.S. at 498 (quoting Pub. L. 91-452, § 904(a) (1970)).
57. Id.
59. Id. at 267–68.
The only difference between the two statutes are the phrases "violation of section 1962" in § 1964(c) and "anything forbidden in the antitrust laws" in section 4 of the Clayton Act. The Court found this difference to be nothing more than a "minor departure in wording" with no effect on the fundamental meaning of the statutes. Furthermore, the relevant part of section 4 of the Clayton Act reads:

Any person who shall be injured in his business or property by any other person or corporation by reason of anything forbidden in the antitrust laws, may sue therefor in any district court of the United States . . . and shall recover threefold the damages by him sustained, and the cost of the suit, including a reasonable attorney's fee.

This language was "originally enacted in 1890 as [section] 7 of the Sherman Act." Courts have long read section 7 of the Sherman Act to incorporate proximate cause. Based on this, the Court reasoned that, because Congress chose to use essentially the same language as section 7 of the Sherman Act when enacting section 4 of the Clayton Act, it intended to adopt the established judicial interpretation of that language, namely, that proximate cause would be required to prove claims made under section 4 of the Clayton Act. The Court applied the same logic to § 1964(c), saying that, because Congress chose to use language from the Clayton Act, it meant to adopt the established judicial interpretation of that language and, therefore, it meant to adopt a proximate cause requirement. At its most basic level, the imposition of a common law proximate cause requirement in civil RICO cases requires that there be a direct relationship between the injury complained of and the injurious conduct alleged. Imposing a proximate cause requirement makes it easier for courts to adjudicate RICO cases because: (1) the less direct an injury is, the harder it is to calculate damages; (2) recognizing the claims of the indirectly injured would force courts to figure out distributional rules since there would inevitably be multiple parties indirectly injured; and (3) a directly injured party can better advocate his position, making it more likely that injurious conduct is deterred. While a proximate cause requirement

63. 18 U.S.C. § 1964(c).
65. Sedima, 473 U.S. at 489 n.8; see supra Part II.B.
70. Holmes, 503 U.S. at 268.
71. Id.
72. Id. at 268–70.
makes the adjudication of these cases easier, it also limits those plaintiffs who can bring civil RICO claims.\(^7\)

**D. Central Bank Eliminates Aiding and Abetting as a Private Cause of Action Under Section 10(b) of the Securities Act**

In *Central Bank v. First Interstate Bank*,\(^7\) the Supreme Court abolished one avenue for individual recovery in securities fraud cases: the private cause of action for aiding and abetting.\(^7\) Prior to this ruling, most courts held that plaintiffs could bring private aiding and abetting actions under section 10(b) of the 1934 Securities Act if they could show: "first, that a primary violation of the Exchange Act had occurred; second, that the aider and abettor had awareness or knowledge of the violation and their assistance to the primary violator (the culpability prong); and third, that the aider and abettor substantially assisted in the primary violation."\(^7\) The Supreme Court, however, completely rejected the inclusion of aiding and abetting actions under section 10(b) of the 1934 Securities Act.\(^7\) The respondents and the SEC, in an amicus brief, argued that the phrase "directly or indirectly" from section 10(b) should be interpreted as the equivalent of "aiding and abetting."\(^7\) The Court rejected this argument because aiding and abetting reaches beyond indirect engagement in an activity barred by section 10(b).\(^8\) Aiding and abetting reaches people who just give a "degree of aid to those" who engage in the section 10(b) fraud.\(^8\) The Court bolstered its legislative argument by pointing out other instances in the Securities Exchange Act where the "direct and indirect" language is used without any indication that it means "aiding and abetting."\(^8\)

While the Court in *Central Bank* felt that the text of both the 1933 and 1934 Securities Acts was sufficient to settle the case,\(^8\) the Court

\(^73\). *Id.* at 268–89.
\(^75\). *Id.*
\(^77\). *Cent. Bank*, 511 U.S. at 175.
\(^78\). 15 U.S.C. § 78j (2006) ("It shall be unlawful for any person, directly or indirectly, . . . (b) [t]o use or employ, in connection with the purchase or sale of any security . . . [,] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe.").
\(^79\). *Cent. Bank*, 511 U.S. at 175–76.
\(^80\). *Id.* at 176.
\(^81\). *Id.*
\(^82\). *Id.*
\(^83\). *Id.* at 177.
felt that it needed to respond to the SEC's policy argument that it raised in its amicus brief. The SEC claimed that a private cause of action for aiding and abetting is an important tool in deterring "secondary actors from contributing to fraudulent activities and ensures that defrauded plaintiffs are made whole." The Court agreed that allowing private causes of actions against aiders and abettors would undoubtedly expand the reach of the statute and strengthen enforcement, but there would be disadvantages as well. The Court specifically pointed to the increasing cost of litigation and the effects of the increase in litigation. Increased costs are realized in higher attorney fees from increased litigation, needless settlements for fear of losing the case at trial, and higher entrance barriers for new, smaller firms entering the market place. The Court did not engage in a normative argument over which policy side weighed heavier, choosing instead to take the path of judicial restraint, leaving the balancing of policy interests to Congress.

E. Section 107 of the PSLRA was Passed Specifically to Bar Securities Fraud as a Predicate Act for a Civil RICO Claim

Passed in 1995, the Private Securities Litigation Reform Act (PSLRA) was an amalgamation of amendments to pre-existing laws designed to improve securities litigation in the United States. The amendment aimed at RICO and added the phrase "except that no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of section 1962" to the existing language of RICO. Based on the plain language of the statute, section 107 of the PSLRA was passed with the express intention of barring plaintiffs from charging predicate acts of securities fraud as the basis for a civil RICO case. Prior to the RICO Amendment, plaintiffs could, and often did, bring civil RICO cases based on the predicate act of securities fraud. When

84. Cent. Bank, 511 U.S. at 188.
85. Id.
86. Id.
87. Id. at 189.
88. Id.
89. Cent. Bank, 511 U.S. at 188.
Congress was debating the PSLRA, the SEC Chairman testified in favor of section 107, saying that "because the securities laws generally provide adequate remedies for those injured by securities fraud, it is both unnecessary and unfair to expose defendants in securities cases to the threat of treble damages and other extraordinary remedies provided by RICO."96 The Conference Committee Report unequivocally states that the Committee intended for section 107 to "eliminate securities fraud as a predicate offense in a civil RICO action."97 The report goes on to say that Congress intended that "a plaintiff may not plead other specified offenses, such as mail and wire fraud, as predicate acts under civil RICO if such offenses are based on conduct that would have been actionable as securities fraud."98 The purpose of the amendment was to prevent plaintiffs from turning a securities fraud case, in which recovery is limited to actual damages, into a civil RICO case, in which plaintiffs could receive treble damages.99

III. Subject Opinion

A. MLSMK Investment Co. v. JP Morgan Chase & Co.

1. Facts

The controversy in MLSMK arose from the fallout from Bernie Madoff's long-running Ponzi scheme.100 Beginning in October of 2008, MLSMK invested $12.8 million with Madoff's investment-advisory business, Bernard L. Madoff Investment Securities (BMIS), losing it all when Madoff was arrested and his assets were seized.101 Madoff promised the clients of his investment-advisory business returns of "up to 10–12% a year," but he never made any investments.102 Instead, he used the money from new investors to pay "returns" to older investors and to himself, "a classic Ponzi scheme."103

JP Morgan Chase (JPMC) was engaged with BMIS as a trading partner in BMIS's legitimate market-making business.104 Madoff allegedly deposited all the money he received from his Ponzi scheme

98. Id.
100. Id. at 270.
101. Id. at 269.
102. Id. at 270.
103. Id.
104. MLSMK, 651 F.2d at 270.
into accounts he had at JPMC, having an average balance of several billion dollars, including MLSMK’s investment.\textsuperscript{105} MLSMK alleges that JPMC developed a derivative product “specifically for use with Madoff-related investments” and then hedged against that risk by investing a substantial amount of money with Madoff.\textsuperscript{106} When BMIS continued to perform strongly in the face of “market mayhem,” JPMC became suspicious and launched an internal due diligence investigation of Madoff’s operations.\textsuperscript{107} By September 2008, JPMC “quietly liquidated” its investments in Madoff’s fund, having concluded that his business was a fraud.\textsuperscript{108}

2. Procedural History

MLSMK alleged that even after JPMC figured out that Madoff’s business was a scam, JPMC continued to trade with Madoff’s market-making business and continued to provide Madoff with banking services because holding the large cash balances in Madoff’s account was too lucrative for JPMC.\textsuperscript{109} MLSMK filed suit in April 2009, alleging that JPMC “conspired to violate RICO . . . by ‘knowingly and purposely conspir[ing]’ with Madoff to further Madoff’s racketeering enterprise” by providing banking services and “by engaging in various RICO ‘predicate acts,’ including ‘numerous interstate wire communications.’”\textsuperscript{110} In June 2009, JPMC filed a motion to dismiss the complaint pursuant to rule 12(b)(6) of the Federal Rules of Civil Procedure, arguing that the RICO claim was barred by section 107 of the PSLRA.\textsuperscript{111} The district court granted JPMC’s motion to dismiss, basing the dismissal of the RICO claim on MLSMK’s failure to adequately plead JPMC’s requisite state of mind.\textsuperscript{112} MLSMK appealed to the Second Circuit.\textsuperscript{113}

3. The Second Circuit’s Opinion in MLSMK

JPMC said in its brief that Congress intended section 107 to bar plaintiffs from relying on predicate acts based on securities fraud “to avoid the ‘so-called treble damages blunderbuss of RICO in securities

\textsuperscript{105} Id. at 271.
\textsuperscript{106} Id.
\textsuperscript{107} Id.
\textsuperscript{108} Id. at 272.
\textsuperscript{109} MLSMK, 651 F.2d at 272.
\textsuperscript{110} Id. at 272–73 (quoting Complaint ¶ 67, MLSMK Inv. Co. v. JP Morgan Chase & Co., 651 F.3d 268 (2d Cir. 2011) (No. 1:09-cv-o4049)).
\textsuperscript{111} Id. at 273. See supra Part IIE (discussing section 107 of the PSLRA).
\textsuperscript{112} MLSMK, 651 F. 2d at 273.
\textsuperscript{113} Id.
fraud cases."  

JPMC argued that MLSMK’s claims arose solely from allegations that JPMC helped Madoff perpetrate securities fraud. MLSMK argued that the RICO Amendment barred civil RICO claims based on securities fraud only in cases “where [the] plaintiff could have asserted a fraud claim against the named defendant.” The Second Circuit had previously found that securities fraud laws do not create a private cause of action for aiding and abetting securities, mail, or wire fraud. Therefore, MLSMK argued that it could not “[assert] a fraud claim against the named defendant” and the RICO Amendment did not apply.

The court looked at the district split that existed in the Second Circuit. In both Fezzani v. Bear Stearns & Co. and Thomas H. Lee Equity Fund v. Mayer Brown, Rowe & Maw LLP, the plaintiffs alleged that “a defendant violated RICO by aiding and abetting another’s securities law violations.” The court in both of these cases followed similar logic, stating that courts cannot keep a loophole open to allow plaintiffs to bring a civil RICO suit so long as they were “pursuing aiders and abettors” simply because their aiding and abetting claims were not actionable. Doing so would negate the protection given to potential defendants by the RICO Amendment. The court in Thomas H. Lee found that the correct interpretation of the RICO Amendment, therefore, is that it “bars claims based on conduct that could be actionable under the securities laws even when the plaintiff, himself, cannot bring a cause of action under the securities laws.”

On the flip side, in OSRecovery, Inc. v. One Groupe International Inc., relied on by MLSMK, the plaintiffs again alleged a RICO claim based on aiding and abetting of another’s securities law violations; however, the court held that the RICO Amendment bars only

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115. Id. at 18.
116. MLSMK, 651 F.3d at 274.
118. MLSMK, 651 F.3d at 274.
119. Id.
122. MLSMK, 651 F.3d at 275 (citing Thomas H. Lee, 612 F. Supp. 2d at 281).
124. MLSMK, 651 F.3d at 275.
RICO "claims based on predicate acts of securities fraud that the plaintiffs could have pursued . . . against the named defendant." 127 The court said that the only question was whether "the [named defendant's] alleged conduct is actionable under those laws." 128 Since the plaintiff's claims against the defendant were not actionable under federal securities laws, the RICO Amendment did not bar them. 129 A district court reached a similar decision in Renner v. Chase Manhattan Bank, 130 in which the court allowed a RICO claim against a bank whose allegations did not provide a "valid basis for a securities fraud claim" because the plaintiffs alleged that the defendant only aided and abetted the fraud of a third party. 131 As a result, there was no actionable securities fraud claim against the bank and the court held that section 107 of the PSLRA did not apply. 132 The Second Circuit felt that OSRecovery failed to consider the Fezzani and Thomas H. Lee courts' interpretation of the statute that a civil RICO claim's viability does not depend on the plaintiff's ability to bring a securities claim against the named defendant; rather, a civil RICO claim's viability depends on the nature of the predicate act itself. 133

The Second Circuit held that the RICO Amendment bars civil RICO claims "alleging predicate acts of securities fraud, even where a plaintiff cannot itself pursue a securities fraud action against the defendant." 134 The court found the plain language of the bill to be persuasively clear. 135 The Amendment is worded broadly and "when Congress stated that 'no person' could bring a civil RICO action alleging conduct that would have been actionable as securities fraud," it "did not mean 'no person except one who has no other actionable securities fraud claim.'" 136 The court found no evidence that Congress wanted the Amendment to be read in the "limited manner that MLSMK urge[d]." The court noted that Congress offered additional avenues for recovery in securities fraud actions when it wanted to do so; therefore, because there is no express language in the RICO Amendment carving out MLSMK's desired loophole, the court con-

127. MLSMK, 651 F.3d at 276.
128. OSRecovery, 354 F. Supp. 2d at 369.
129. Id. at 371.
131. MLSMK, 651 F.3d at 277 (quoting Renner, 1999 WL 47239, at *6).
132. Id.
133. Id. at 279.
134. Id. at 277.
135. Id. at 278.
cluded that Congress did not intend to preserve a similar avenue for recovery in civil RICO actions. The court found that the legislative history of the PSLRA bolstered its interpretation of the RICO amendment. The Conference Committee report states that the purpose was to “remove [as a predicate act of racketeering] any conduct that would have been actionable as fraud in the purchase or sale of securities as racketeering activity under civil RICO.” The Senate Report also suggests that Congress was satisfied that securities laws “generally provide adequate remedies for those injured by securities fraud.”

The Second Circuit further bolstered its decision by noting that there are similarly decided cases in other federal circuits. The court noted that in those cases, like here, federal courts barred the plaintiffs’ RICO claims based on the RICO Amendment despite the fact that plaintiffs were left with no recourse for private recovery under securities law.

B. Buscher Article

In his Comment, Michael Buscher took issue with the Second Circuit’s decision in MLSMK. Buscher starts out by acknowledging that the Second Circuit’s decision follows the larger judicial trend of narrowing the scope of the RICO Amendment, which started in 1992 with the Holmes decision. However, he goes on to critique the opinion on both legal and policy grounds, arguing that the court overstated its case, thereby leaving potentially innocent victims out in the cold without a path to private recovery even when they are legitimately harmed, while encouraging actors like JPMC to turn a blind eye to securities fraud and reap the benefits.

Buscher first claims that the court overstated the lack of ambiguity in the statute’s wording. He used the decisions in OSRecovery and Renner as evidence that the Second Circuit overlooked the ambiguity

137. Id. (citing Cent. Bank v. First Interstate Bank, 511 U.S. 164, 177 (1994)).
138. Id.
140. Id. (quoting S. Rep. No. 104-98, at 19 (1995)).
141. MLSMK, 651 F.3d. at 280 (citing Affco Invs. 2001 L.L.C. v. Proskauer Rose L.L.P., 625 F.3d 185 (5th Cir. 2010); Bixler v. Foster, 596 F.3d 751 (10th Cir. 2010); Howard v. Am. Online, Inc., 208 F.3d 741 (9th Cir. 2000); Bald Eagle Area Sch. Dist. v. Keystone Fin., Inc., 189 F.3d 321 (3d Cir. 1999)).
142. Id. at 280.
143. Buscher, supra note 14.
144. Id. at 208–09.
145. Id. at 211.
146. Id. at 209.
created by the word "actionable" in the statute.\textsuperscript{147} Section 107 of the PSLRA amended § 1964(c) of RICO to read, "no person may rely upon conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of section 1962."\textsuperscript{148} Both cases used similar logic, stating that, because aiding and abetting securities fraud is not actionable under section 10(b) of the Exchange Act, per the decision in \textit{Central Bank}, such action does not fall under the umbrella of section 107 of the PSLRA.\textsuperscript{149} Buscher furthers his argument, saying that it is this interpretation of the breadth of section 107, not the interpretation adopted by the Second Circuit, that is the most obvious.\textsuperscript{150}

Buscher then claims that the Second Circuit overstated the clarity in the PSLRA's legislative history.\textsuperscript{151} He claims that the court "clearly ignored the general theme underlying the amendment: to deter and bar meritless claims."\textsuperscript{152} He quotes from the Senate Report of the PSLRA saying that it "aims 'to encourage plaintiffs' lawyers to pursue valid claims'" and that it was "expected to continue 'to provide the highest level of protection to investors in our capital markets.'"\textsuperscript{153} Buscher says that an investor, like MLSMK, should be afforded the "highest level of protection" in the way that the Senate Report indicated was intended by the PSLRA.\textsuperscript{154} Further, Buscher says that, far from being a meritless claim (of the kind the PSLRA was designed to stop), "[i]t is clear that MLSMK's claim against JPMC was meritorious."\textsuperscript{155} JPMC conducted an investigation into BMIS's suspiciously successful business, discovered—or was skeptical enough to pull out its own investments—the Ponzi scheme, but continued to let others be schemed out of their investments, all while continuing to profit off of the scheme.\textsuperscript{156} Buscher admits that the passage of legislative history that the Second Circuit relied on specifically bars securities related conduct from being a predicate act for a RICO case.\textsuperscript{157} However,

\textsuperscript{147.} \textit{Id.} (citing OSRecovery, Inc. v. One Groupe Int'l, Inc., 354 F. Supp. 2d 357, 368–70 (S.D.N.Y. 2005); Renner v. Chase Manhattan Bank, No. 98 Civ. 926 (CSH), 1999 WL 47239, at *7–9 (S.D.N.Y. Feb. 3, 1999)).


\textsuperscript{149.} \textit{OSRecovery, Inc.}, 354 F. Supp. 2d at 368–70; \textit{Renner}, 1999 WL 47239, at *7–9.

\textsuperscript{150.} Buscher, \textit{supra} note 14, at 209.

\textsuperscript{151.} \textit{Id.}

\textsuperscript{152.} \textit{Id.} at 210.

\textsuperscript{153.} \textit{Id.} at 209 (quoting \textit{S. REP. No. 104-98, at 4 (1995)}).

\textsuperscript{154.} \textit{Id.}

\textsuperscript{155.} Buscher, \textit{supra} note 14, at 210.

\textsuperscript{156.} \textit{Id.}

\textsuperscript{157.} \textit{Id.} ("The Committee intends this amendment to eliminate securities fraud as a predicate act of racketeering in a civil RICO action." \textit{S. REP. No. 104-98, at 19 (1995)}).
Buscher feels that the court focused on this passage to the exclusion of the larger stated aims of the amendment: deterring meritless claims and protecting investors. Buscher implies that it was a desire to follow the judicial trend of narrowing RICO that drove the Second Circuit’s decision rather than the clearest interpretation of the statute and its legislative history.

Buscher also raises significant objections to the Second Circuit’s opinion on policy grounds. With the advent of the Central Bank ruling that there could be no private actions brought under section 10 of the Securities Act for merely aiding and abetting securities fraud, victims of such fraud had to turn to RICO as a last chance at recovery. With the passage of the PSLRA, and its interpretation in the MLSMK case, many victims are left “without valid recourse against those profiting from fraudulent securities conspiracy.” One of the goals of the PSLRA, as recognized by the Second Circuit, was to prevent “bootstrapping” security fraud claims into RICO claims with the possibility of treble damages. However, in MLSMK, there was no securities claim to “boot-strap” up from, and, without the possibility for a RICO claim because of the PSLRA, there was no recovery at all.

Buscher’s policy critique tracks closely with that of dissenting Senators from the passage of the PSLRA. Buscher admits that reducing meritless claims is important, but he goes on to contend that doing so comes with several problems. He quotes Senator Chris Dodd saying that “we must do all that we can to ensure that legitimate victims can continue to sue and can recover damages quickly.” Buscher’s critique, in essence, says that the statute, combined with the judicial precedent of Central Bank and MLSMK, over-solves the issue of reducing meritless RICO claims. In the haste to get rid of meritless claims, the legal system has taken away legitimate victims’ ability to recover their losses from fraudulent activity.

Buscher also takes issue with the incentives that the MLSMK decision creates. Without an avenue for private recovery, JPMC would now be incentivized to continue to “reap the benefits of other’s fraudulent investment activities” at the expense of “innocent investors”
such as MLMK. Buscher seems to favor the plan of three dissenting Senators (Sarbanes, Bryan, and Boxer) to include in the PSLRA a legislative override to the Central Bank decision in order to allow aiding and abetting security fraud to be actionable. While this would not allow plaintiffs to receive the treble damages that a RICO claim would allow, it would give plaintiffs an avenue for compensatory damages.

C. Riffe Article

In her Comment, Eliza Riffe examines federal circuit courts’ interpretations of the RICO Amendment, the legislative history of the PSLRA, and policy arguments that support her position. She advocates for what she calls a “narrow” interpretation of the RICO Amendment, arguing that the amendment should be read to allow cases in which the specific claim would not have been actionable under securities laws. Riffe contrasts this approach with the “absolute preclusion” model exemplified by the Second Circuit’s decision in MLMK. She argues for a narrow interpretation of the RICO Amendment because a narrow interpretation is more consistent with the amendment’s legislative history and is supported by several policy reasons.

Riffe first argues that there is a circuit split regarding the interpretation of the RICO Amendment, or, at the very least, the issue remains unsettled. She says that the Second (in MLMK), Third, and Ninth Circuits use a broad interpretation by utilizing the “absolute preclusion” model, while the Fifth and Tenth Circuits use a narrow interpretation by utilizing the “actionability analysis.” Riffe’s basis for asserting that there is a circuit split is the Affco Investments v. Proskauer Rose case in the Fifth Circuit and the Bixler v. Fowler case in the Tenth Circuit. In both cases, the courts turned to the common law that has emerged around securities laws. In Affco, the court looked to the Howey test to determine if the interests in question con-

167. Id.
168. Id. at 210.
169. Id.
171. Id. at 485.
172. Id. at 476.
173. Id. at 485–89.
174. Id. at 471.
175. Riffe, supra note 14, at 472–73.
176. Id. at 481–82; see Affco Invs. 2001 L.L.C. v. Proskauer Rose L.L.P., 625 F.3d 185 (5th Cir. 2010); see also Bixler v. Foster, 596 F.3d 751 (10th Cir. 2010).
stitute an "investment contract" and if they consequently fell under the auspices of securities fraud. In *Bixler*, the court examined whether or not the relevant transaction established a "purchase or sale" for the purpose of securities laws. Riffe contends that the approaches used in both of these cases are sufficiently different than those used in "absolute preclusion" circuits like the Second Circuit. The essence of the difference between these two approaches is that in the "absolute preclusion" circuits courts look to the pleadings for anything that "looks and smells like securities fraud," while the "actionability analysis" circuits "test the claim's viability under various legal theories to see if it is, in fact, actionable under existing securities laws." When examining the legislative history of the PSLRA, Riffe relies on two main arguments. First, she points out that section 108 of the PSLRA includes a "savings clause" which says that "the amendments made by this title shall not affect or apply to any private action arising under title I of the Securities Exchange Act of 1934 or title I of the Securities Act of 1933, currently pending." Riffe contends that the specific enumeration of the Securities Exchange Act of 1934 and the Securities Act of 1933 indicates a narrow meaning of the RICO Amendment: the amendment should apply only to those situations that are actionable under those two statutes. Second, Riffe examines the path that the language of the RICO Amendment took, beginning with the language that was proposed in the Senate to the final language that was passed into law. The proposed language from the Senate read: "no person may bring an action under this provision if the racketeering activity . . . involves fraud in the sale of securities," while the final language reads: "would have been actionable." Riffe asserts that the narrowing of this language from "involves" to "would have been actionable" indicates that Congress wanted a narrow interpretation of the RICO Amendment.

In her policy argument, Riffe uses error analysis to argue that a narrow interpretation of the RICO Amendment will lead to lower er-

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178. Riffe, supra note 14, at 483.
179. Id. at 481.
180. Id. at 472.
181. Id. at 486.
183. Riffe, supra note 14, at 486.
184. Id. at 488.
185. Id.
ror costs than a broader interpretation. First, she argues that the narrow interpretation is consistent with the "rule of lenity," a common canon of statutory construction. The rule of lenity directs courts to choose the more narrow interpretation of a statute when there are two possible interpretations of an ambiguous passage and one interpretation is harsher than the other. Second, she contends that the proper enforcement of Rule 9(b) of the Federal Rules of Civil Procedure will guard against undermining the goal of reducing meritless litigation of the PSLRA. Rule 9(b) says that, when asserting fraud, the litigants must plead it with specificity. Riffe argues that proper enforcement of this rule will ensure that plaintiffs have no other recourse than securities fraud under RICO.

IV. Analysis

A. Legal Arguments Against the Second Circuit are Unpersuasive

As indicated in Buscher's article, the legal case against the Second Circuit's opinion in MLSMK is weak. Bringing a RICO suit based on aiding and abetting securities fraud is barred on the face of the relevant amendment. The relevant language states, "no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of section 1962." The best argument against this clear statutory bar is found in the courts' reasoning in OSRecovery and Renner. Because Central Bank bars aiding and abetting from being "actionable as [securities] fraud," section 107 of the PSLRA cannot apply because the case is not "actionable as [securities] fraud." This line of reasoning is a seductive attempt to get around the harsh language of the statute. Contrary

186. Id.
187. Id.
188. Riffe, supra note 14, at 488.
189. Id. at 489.
190. Id.
191. Id.
192. Buscher, supra note 14, at 211 ("[W]hile the language of the statute itself was not at all as unambiguous as the Second Circuit made it seem, the specific provisions found within the legislative history of the act are supportive of the court's conclusion. Additionally, the court's decision is supported by the general trend in narrowing the civil scope of the RICO statute.").
194. Id.
to Buscher, the Second Circuit did engage with, and ultimately dismiss, this argument. In quoting another court, the Second Circuit said that Congress "did not specify that the conduct had to be actionable as securities fraud by a particular person to serve as a bar to a RICO claim by that same person."  

The Second Circuit went further, quoting another case that said that the plain language of section 107 of the PSLRA "does not require that the same plaintiff who sues under RICO must be the one who can sue under securities law." Extrapolating that reasoning to this case, the predicate act of Madoff's security fraud is what bars MLSMK from bringing the RICO claim. Madoff's fraud is the dominant act, serving as the predicate act for both the aiding and abetting charge against JPMC and the racketeering charge. Any damage suffered here necessarily stems from the predicate act of BMIS's security fraud, and that cannot be used to establish an 18 U.S.C. § 1962 RICO charge against any party according to the PSLRA. Riffe's preferred method of analysis, the so-called "actionability analysis," does not necessarily foreclose this reading of the statute. Riffe wants the courts to search for actual securities fraud under the Securities Act of 1933 and the Securities Exchange Act of 1934; here, Madoff's security fraud clearly falls under the auspices of the Securities Acts.

Buscher concedes that the legislative history of the PSLRA "unambiguously bars plaintiffs from making civil RICO claims predicated on securities fraud." In the relevant committee report, it states that Congress' intent was "to eliminate securities fraud as a predicate act of racketeering in a civil RICO action." Buscher attempts to claim that, despite the "unambiguous" bar, focusing on that bar does not specifically allow a court to take into account the "general theme underlying the amendment" of deterring meritless RICO claims. Even if the court did not take the general theme into account, the

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196. Buscher, supra note 14, at 209 ("[B]ecause at least two district courts had relied on the term actionable in determining that an aiding and abetting securities fraud claim escaped the RICO amendment, the language at issue obviously is not as plainly 'unambiguous' as the court found.").


199. Id. (quoting Tittle v. Enron Corp. (In re Enron Corp. Sec., Derivative & ERISA Litig.), 284 F. Supp. 2d 511, 620 (S.D. Tex. 2003)).


201. Riffe, supra note 14, at 485–86.


opinion and the legislative history clearly indicate that the Court and Congress did consider the effects of the RICO Amendment on innocent investors.\textsuperscript{205} The Second Circuit says that it is "clear from the Senate Report that Congress was aware that the RICO Amendment would place some claims ... outside the reach of private civil RICO suits."\textsuperscript{206}

Riffe utilizes a more subtle take on the legislative history, focusing on the PSLRA's path of enactment and the narrowing of the statutory language from its proposed version to the final version. Riffe's approach, however, mischaracterizes the nature of the PSLRA's final language. While the PSLRA's language may have been narrowed from the version originally passed in the Senate, the final language retains a broadly worded clause, barring "any conduct that would have been actionable" under securities laws.\textsuperscript{207} The breadth of the phrase "any conduct" supports a preclusive reading of the RICO Amendment.

That Buscher was able to cite Senators Sarbanes, Bryan, and Boxer from the record, saying that they wished to overturn Central Bank and allow private recovery for aiding and abetting securities fraud, shows that Congress considered overturning Central Bank and allowing private recovery for aiding and abetting securities fraud during the legislative process and chose not to do so.\textsuperscript{208} In fact, the Senate Report quoted in the MLMK opinion states that, "[t]he Committee believes that amending the 1934 [Securities Exchange] Act to provide explicitly for a private aiding and abetting liability actions under Section 10(b) would be contrary to [the RICO Amendment's] goal of reducing meritless securities litigation."\textsuperscript{209} Buscher's argument that the RICO Amendment's legislative history shows that Congress did not consider that the amendment would leave some potential plaintiffs out in the cold with no avenue for recovery is simply incorrect.

B. The Policy Arguments

The policy arguments articulated in Buscher's article against the MLMK decision also fail under scrutiny. Buscher's primary policy argument against the MLMK decision is that the decision failed to protect innocent investors.\textsuperscript{210} This argument is based on Senator

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\item \textsuperscript{205} MLMK Inv. Co. v. JP Morgan Chase & Co., 651 F.3d 268, 279 (2d Cir. 2011).
\item \textsuperscript{206} Id.
\item \textsuperscript{207} 18 U.S.C. § 1964(c) (2006) (emphasis added).
\item \textsuperscript{208} Buscher, supra note 14, at 210.
\item \textsuperscript{209} MLMK, 651 F.3d at 279 (quoting S. Rep. No. 104-98, at 19 (1995)).
\item \textsuperscript{210} Buscher, supra note 14, at 210.
\end{itemize}
Dodd’s quote: “[W]e must do all that we can to ensure that legitimate victims can continue to sue and can recover damages quickly.”\textsuperscript{211} This is a noble principle to follow; however, Buscher’s application of this principle to the \textit{MLSMK} case is misguided. He argues that \textit{MLSMK} was a legitimate victim and JPMC benefited from BMIS’s illegal activity; therefore, JPMC must be held liable.\textsuperscript{212} While it is true that \textit{MLSMK} is a legitimate victim of fraud, it is a victim of Bernie Madoff and BMIS, not JPMC. Although Madoff is beyond the reach of RICO damages, which he should be liable for, this does not mean that \textit{MLSMK} is entitled to damages from anyone else connected to the fraud.

One of the reasons \textit{Central Bank} did not allow private recovery for aiding and abetting securities fraud, as articulated by the \textit{Fezzani} court, is that a “plaintiff could deliberately plead facts that established no more than that a particular defendant aided and abetted another’s securities fraud. Such incentive is particularly strong where . . . a plaintiff might rely on the securities fraud of those with few assets to obtain treble damages against deeper pockets.”\textsuperscript{213} Allowing recovery for aiding and abetting casts too wide a net for potential defendants, allowing the plaintiff to seek out any deep pocket that could conceivably be connected to the fraud. The leverage given to plaintiffs by the treble damages provision in RICO, coupled with the lowered standing barrier, could lead to an increase in coercive lawsuits aimed at a leveraged settlement rather than full litigation.

Buscher also argues that by not allowing a private right of action for aiding and abetting by overturning \textit{Central Bank}, the Second Circuit created perverse incentives for actors like JPMC to continue to turn a blind eye and profit off of fraudulent behavior while innocent investors like \textit{MLSMK} get bilked.\textsuperscript{214} While it is true that there is greater incentive for JPMC to act in such a manner without the private right to recovery than there would be if \textit{Central Bank} were overturned, this does not mean that there are no deterrents against JPMC from continuing to act in that manner. As the Second Circuit pointed out in \textit{MLSMK}, Congress considered the lack of deterrents created by \textit{Central Bank} and, to fix this, Congress explicitly “grant[ed] the SEC express authority to bring actions seeking injunctive relief or money damages against persons who knowingly aid and abet primary viola-

\begin{itemize}
\item \textsuperscript{211} \textit{Id.} at 211 (quoting \textit{S. Rep. No.} 104-98, at 51).
\item \textsuperscript{212} \textit{Id.} at 210.
\item \textsuperscript{214} Buscher, \textit{supra} note 14, at 211.
\end{itemize}
tors of the securities laws." The Senate Report clearly indicates that the Senate was "satisfied that the securities laws 'generally provide adequate remedies for those injured by securities fraud.'" Although there is no private cause of action deterring fraudulent behavior, this does not mean that a properly executed public cause of action cannot be an effective deterrent.

Riffe's policy concerns closely track Buscher's policy concerns. Riffe is uneasy about the possibility of a "small but important class of cases at the margins that would be filtered out" without a narrow interpretation of the RICO Amendment. She frames her concern as error cost allocation, arguing that the costs of mistakenly dismissing or allowing a case to proceed are more onerous on potential plaintiffs rather than mistaken defendants.

As the court in Central Bank articulated, "[p]olicy considerations cannot override our interpretation of the text and structure of the Act, except to the extent that they may help to show that adherence to the text and structure would lead to a result 'so bizarre' that Congress could not have intended it." While Buscher and Riffe's policy concerns are certainly arguable, it is hard to imagine them ever overriding the clear evidence that Congress intended for the result in MLSMK. Certainly, Riffe and Buchser's concerns do not rise to the level of such a "bizarre" result that "Congress could not have intended it." The legislative history shows that Congress specifically considered and rejected allowing aiders and abettors a private right of action, it increased the public cause of action, and was content with this outcome.

V. Conclusion

The Second Circuit's decision in MLSMK, in which the court rejected the plaintiff's civil RICO claim on the basis that section 107 of the PSLRA barred civil RICO claims based on predicate acts that could be actionable as securities fraud, was correctly decided on both legal and policy grounds. The plaintiff argued that the predicate act

216. Id.
217. Riffe, supra note 14, at 489.
218. Id.
220. Id.
221. Riffe, supra note 14, at 486.
222. Id. at 489.
223. Id.
that served as the basis of its RICO claim—aiding and abetting securities fraud—was not covered by the PSLRA because the Central Bank decision had rendered aiding and abetting not actionable as securities fraud. Alternatively, the plaintiff argued that it was exempt from the PSLRA because, without a civil RICO claim, it would have no other avenue for recovery for its very real loss. The Second Circuit correctly found neither argument persuasive. The text, legal precedent, and legislative history of the PSLRA all indicate that the plaintiff's claim was based on a predicate act—the underlying Ponzi scheme—that was actionable as securities fraud and that Congress had considered leaving injured plaintiffs out in the cold with no avenue for recovery and decided the benefits of the legislation as drafted outweighed the costs.

225. Id.