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Eliza Clark Riffe

INTRODUCTION

Since its enactment in 1970, the Racketeer Influenced and Corrupt Organizations Act (RICO) has proved to be a divisive statute. Critics have expressed particular discomfort with the Act's civil remedies provision, which permits litigants injured by a RICO enterprise to sue in federal court and, in some cases, to collect treble damages. In 1989, then-Chief Justice William Rehnquist even called for the repeal of RICO's civil remedies section. He argued that the provision and its high ceiling for damages created perverse incentives for plaintiffs’ lawyers, who were unrestrained by the discretion exercised by criminal prosecutors, to sue under RICO when their cases were merely "[g]arden-variety frauds and swindles” better left to state courts.

One area of concern for critics like Rehnquist was securities litigation. A spate of high-profile white-collar cases led a majority in the US Congress to determine that securities litigation under RICO had become abusive. In 1995, Congress passed the Private Securities Litigation Reform Act (PSLRA), which amended RICO to preclude civil actions based upon "conduct that would

† AB 2006, The University of Chicago; JD Candidate 2013, The University of Chicago Law School.
2 See 18 USC § 1964(c).
4 See, for example, Securities Litigation Reform, HR Rep No 104-369, 104th Cong, 1st Sess (1995) (citing testimony of SEC Chairman Arthur Levitt: “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.”).
have been actionable as fraud in the purchase or sale of securities.”

The language of this amendment has become the source of ongoing ambiguity in securities law. In particular, courts have struggled with the phrase “would have been actionable.” The enacting Congress may have intended the phrase to be read broadly: no claims sounding in securities fraud should arise under RICO. Some plaintiffs, though, contend that the provision only blocks claims that are “actionable” elsewhere. If a claim would not “have been actionable” under existing securities laws, these plaintiffs argue, then the PSLRA amendment to RICO does not preclude their suits. A circuit split along multiple axes has emerged among courts grappling with this question of statutory interpretation.

If the state of securities litigation under RICO is, as Rehnquist and the other critics argued, abusive and duplicative, then one could contend that the PSLRA amendment to RICO should be read broadly to forbid all claims sounding in securities fraud, even associated RICO claims that do not describe securities fraud. On the other hand, there remains the possibility that securities litigants, like prosecutors who use the Act against organized crime syndicates, bring their actions under RICO when they have no other legal alternatives. If this is the case, then a broad reading would permit individuals who engage in securities fraud to go unpunished and under-deterred. Courts wishing to allow plaintiff-victims of securities fraud a day in court should read the provision narrowly—that is, to bar only those claims that are already actionable under federal securities laws. This line of reasoning has persuaded several federal judges and has resonated with victims of Ponzi schemes like the one constructed by Bernard Madoff.

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6 PSLRA § 107, 109 Stat at 758, codified at 18 USC § 1964(c). The amended provision reads:

Any person injured in his business or property by reason of a violation of [18 USC § 1962] may sue therefore in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney’s fee, 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 [18 USC § 1962]. The exception contained in the preceding sentence does not apply to an action against any person that [sic] is criminally convicted in connection with the fraud, in which case the statute of limitations shall start to run on the date on which the conviction becomes final.

Id.
In this Comment, I will examine both views and then argue that courts have unduly dismissed the second, narrower approach, which would allow plaintiffs to proceed beyond the pleading stage if they can demonstrate conclusively that their claims are not otherwise actionable under state or federal law. The way to achieve this duly cautious approach is to engage in a rigorous examination of the case at bar to determine whether it could be pursued without the use of RICO.

This Comment will therefore argue for a narrower reading of the PSLRA. Part I of this Comment explores the legislative history and language of both RICO and PSLRA. Part II discusses the various judicial interpretations of the scope of the PSLRA amendment, and in particular the ways in which courts have differed in their methodologies. Part II draws a distinction between these methodologies based on a difference in approach identified by this Comment. Part III argues that a narrow reading of the amendment can take concrete form: this Comment advocates for a more thorough jurisprudential methodology, or “actionability analysis,” for courts hearing potential RICO securities suits. Text, legislative history, and policy considerations all support this reading. Part IV concludes.

I. STATUTORY BACKGROUND

A brief overview of the two statutes in play—RICO and PSLRA—enriches an evaluation of the split among courts. The current judicial controversy over how best to read the RICO amendment contained in the PSLRA recapitulates the vigorous debate and frequent revisions the amendment underwent before enactment. Many of the arguments advanced by litigants in the courts first appeared in Congress. Part IA explores the history of RICO and its evolution as a tool against white-collar crime. Part IB recounts the legislative high drama that accompanied the passage of the PSLRA amendment to RICO.

A. RICO and White-Collar Crime

RICO permits an individual injured by another’s violation of the statute to file a civil suit to recover “threefold the damages he sustains and the cost of the suit.”\(^7\) A successful civil claim under RICO must prove four elements: (1) conduct; (2) of an enterprise;
(3) through a pattern; (4) of racketeering activity.\(^8\) The "pattern" can be established by proving two "predicate acts" within ten years. "Racketeering activity" includes "any act which is indictable under a lengthy list of criminal offenses, including the federal statutes prohibiting mail and wire fraud."\(^9\)

Congress passed RICO in 1970 after decades of rumination by all three branches of government about how to remedy the doctrinal problem presented by organized crime.\(^10\) Prosecutors had found the traditional legal structure, particularly the crime of conspiracy, inadequate for dealing with pervasive and sophisticated criminal enterprises in which labor was divided, illegal activities were woven in with legitimate business, and criminal tasks were often delegated.\(^11\) Prosecutors have since wielded the statute as a powerful weapon against organized crime.\(^12\)

RICO's utility has not been confined to Mafia activity. Attorneys in the US have also built high-profile white-collar criminal cases around the statute, such as the indictment of "junk bond king" Michael Milken and investigation of his firm, Drexel Burnham Lambert.\(^13\) Early drafts of the RICO bill forbade membership in criminal enterprises, but because such a provision was thought likely to run afoul of the Constitution,\(^14\) the statute as

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\(^8\) Eagletech Communications Inc v Citigroup, Inc, 2008 WL 3166533, *33-34 (SD Fla), citing Langford v Rite Aid of Alabama, Inc, 231 F3d 1308, 1311 (11th Cir 2000).

\(^9\) Eagletech Communications, Inc, 2008 WL 3166533 at *33-34.

\(^10\) See, for example, G. Robert Blakey, RICO: The Genesis of an Idea, 9 Trends in Organized Crime 8, 9 (2006) (indicating that the "legislative process that ultimately resulted in . . . RICO begins with Senator Royal S. Copeland's hearings into racketeering in the 1930s").

\(^11\) For a comparison of traditional conspiracy doctrine to RICO, see, for example, James F. Holderman, Reconciling RICO's Conspiracy and "Group" Enterprise Concepts with Traditional Conspiracy Doctrine, 52 U Cin L Rev 385, 390 (1983) (contrasting RICO's enterprise liability with traditional "wheel" and "chain" conspiracy approaches).

\(^12\) See, for example, United States v Umana, 2010 WL 1688441 (WD NC); United States v Trucchio, 2006 WL 1529073 (MD Fla); United States v Salerno, 631 F Supp 1364 (SDNY 1986), revd on other grounds by United States v Salerno, 481 US 739 (1987) (affirming applicability of RICO and deciding case on constitutional grounds).


\(^14\) See Statement by Attorney General Nicholas deBelleville Katzenbach to the Subcommittee on Criminal Laws and Procedures of the Senate Judiciary Committee, 5 (DOJ Mar 22 1966), online at http://www.justice.gov/ag/aghistory/katzenbach/1966/03-22-19 66.pdf (visited Sept 10, 2012). The Attorney General testified as follows: [The Senate draft bill] raises a number of constitutional questions of such substance that, at the very least, its effectiveness is very likely to be impaired by prolonged litigation. . . . Conceivably, First Amendment problems might [] be
enacted forbids conduct only. This revision probably did a great deal to widen RICO's scope: it does not explicitly prohibit membership in the Mafia, but rather prohibits actions on behalf of any enterprise, a category that swallows a wider range of activity than just Mafia membership, including forms of white-collar crime.\footnote{5} G. Robert Blakey, the Notre Dame law professor who was instrumental in drafting the statute, has insisted, though, that the statute's drafters always contemplated the inclusion of white-collar crime, and that it was not, as critics have suggested, "an accidental product of a drafting process focused elsewhere."\footnote{16}

Blakey told Time magazine in 1989 that "[w]e don't want one set of rules for people whose collars are blue or whose names end in vowels, and another set for those whose collars are white and have Ivy League diplomas."\footnote{17}

In 1980, nine years before Rehnquist called for the repeal of civil RICO, Blakey complained that private plaintiffs had "not yet begun to take advantage of RICO's promise in the civil area."\footnote{18} In the years between Blakey's call for increased use of RICO's civil provisions and Rehnquist's concern that they were overused, the number of securities fraud cases under RICO increased dramatically and commentators began to suspect that the litigation was abusive and beyond the scope of the Act.\footnote{19} One report has indicated that, "by the mid-1980's, it was estimated that thirty-five percent of published civil RICO decisions relied..."
solely or primarily on allegations of securities fraud; approxi-

mately ninety percent relied upon one of the three ‘commercial 

fraud’ predicate offenses—mail fraud, wire fraud, or securities 

fraud,” while virtually no cases sounded in securities fraud be-

fore the 1980s.

One such case reached the Supreme Court in 1985. In *Sedima 

v. Imrex*, the Court overturned a Second Circuit holding that 

securities fraud claims were not viable under RICO because they 

were outside the scope of the statute’s intent. "RICO is to be 

read broadly," Justice White wrote for the majority. Justices 

Marshall and Powell both dissented. Marshall worried that the 

majority’s interpretation "validate[d] the federalization of broad 

areas of state common law of frauds, and it approve[d] the dis-

placement of well-established federal remedial provisions." 

Powell argued that the Court had a duty to read the statute nar-

rowly, even if its language remained broad, to fulfill original leg-

islative intent: “RICO has been interpreted so broadly that it has 

been used more often against respected businesses with no ties 

to organized crime, than against the mobsters who were the 

clearly intended target of the statute.” The stage was set for the 

PSLRA amendment.

B. PSLRA and RICO: The 1995 Amendment

The PSLRA was a lengthy piece of legislation aimed at eradi-

cating a wide swath of litigation practices thought to be abusive.

The statute originated in the Republican Party’s 1994 “Contract 

with America,” an itemized list of policy issues the embattled 

party pledged to prioritize if elected.

The draft version of the bill contained no mention of RICO 

when it first appeared in the House of Representatives from the

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22 Id at 481.

23 Id at 497. Rehnquist joined in the majority.

24 Id at 501 (Marshall dissenting).


Committee on Commerce in February of 1995. In floor debate a week after the bill was introduced, California Republican Representative and future Securities and Exchange Commission (SEC) chairman Christopher Cox proposed the RICO amendment. Cox explained that the omission of RICO from the bill was merely the product of administrative oversight; he and the bills' other sponsors had always intended to include it, but it slipped through the cracks as the bill travelled through the Commerce and Judiciary Committees before reaching the floor.

Cox faced immediate opprobrium from Democrat John Conyers, who worried that the RICO amendment was overreaching and would bar worthy lawsuits, including some of the high-profile white-collar cases dominating the news around the time of enactment: "By blocking all possibility of civil RICO lawsuits for securities fraud, the Cox amendment would incredibly harm plaintiffs such as the elderly bondholders who were cheated out of their life's savings by Charles Keating in the Lincoln Savings and Loan debacle," Conyers argued. "It would deny any effective remedy for the thousands of depositors of the Bank of Credit and Commerce International, the notorious BCCI, which regulators from 62 countries united to shut down because of the bank's fraudulent practices." Conyers, moreover, implied that Cox and the bill's other sponsors had more sinister reasons for waiting to amend the bill. "[T]his amendment was hastily put together without the benefit of any hearings or debate in any committee or the possibility of a markup where there could have been important improvements, and now within an 8-hour ambit, we are asked to consider the revocation of the greatest single crime-fighting bill provision, RICO, on the law books today." The bill with the Cox amendment passed in the House over Conyers' objections.

The first version of the bill that appeared in the Senate, though, did contain a RICO provision when it reached the floor in January of 1995. Senate Bill 240, which originated in the Committee on Banking, Housing, and Urban Affairs, contained a

27 See A Bill To Reform Federal Securities Litigation (As Introduced in the House), HR 1058, 104th Cong, 1st Sess (Feb 27, 1995).
28 Securities Litigation Reform Act, H 1058, 104th Cong, 1st Sess (Feb 27, 1995), in 141 Cong Rec H 2717 (Mar 6, 1995) (Cox amendment).
29 Securities Litigation Reform Act, H 1058, 104th Cong, 1st Sess (Feb 27, 1995), in 141 Cong Rec H 2759 (Mar 7, 1995).
section amending RICO to read: "[N]o person may bring an action under this provision if the racketeering activity . . . involves fraud in the sale of securities." 31 Then-Delaware Senator Joe Biden voiced concern about the RICO provision, deeming it "a bad idea." 32 As a refinement, he proposed an exception to the securities fraud preclusion: the RICO provision "shall not apply if any participant in fraud is criminally convicted; then RICO can apply, and the statute does not begin to toll until the day of the conviction becomes final." 33

These debates did not end after each house of Congress approved its respective bill. The House rejected the Senate version and a conference committee convened to prepare a final draft. The conference bill combined several provisions proposed in each house to reform federal securities lawsuits. Among them were new rules governing private securities class actions, a grant of safe harbor for forward-looking statements made by companies reporting under the 1934 Act, and confirmation that the SEC—but not private litigants—had authority to sue for aiding and abetting. 34

President Bill Clinton then joined the fray, vetoing the conference committee version of the bill and echoing Representative Conyers' concerns: "I am not . . . willing to sign legislation that will have the effect of closing the courthouse door on investors who have legitimate claims. Those who are the victims of fraud should have recourse in our courts." 35 Both houses of Congress overrode the veto and the PSLRA became law in December of 1995. 36

The RICO amendment that emerged from the political maneuvering and debate became § 107 of the PSLRA. The provision reads, in relevant part:

Any person injured in his business or property by reason of a violation of [18 USC § 1962] may sue therefore in any

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31 Private Securities Litigation Reform Act, S 240, 104th Cong, 1st Sess, in 141 Cong Rec S 1070 (June 22, 1995).
32 Private Securities Litigation Reform Act, S 240, 104th Cong, 1st Sess, in 141 Cong Rec S 9150 (June 27, 1995).
33 Id.
34 PSLRA, 109 Stat 737.
36 New Public Laws, 104th Cong, 1st Sess, in 141 Cong Rec D1511 (daily ed Dec 22, 1995) (reporting that the PSLRA "[b]ecame Public Law over the objections of the President").
appropriate United States district court and shall recover
threefold the damages he sustains and the cost of the suit,
including a reasonable attorney's fee, except that no per-
son may rely upon any conduct that would have been ac-
tionable as fraud in the purchase or sale of securities to es-
tablish a violation of [18 USC § 1962]. The exception con-
tained in the preceding sentence does not apply to an ac-
tion against any person that is criminally convicted in
connection with the fraud, in which case the statute of
limitations shall start to run on the date on which the
conviction becomes final.\textsuperscript{37}

The amendment provides that "no person may rely upon any
conduct" that relies upon securities fraud to pursue a RICO
claim.\textsuperscript{38} Section 107 does not contain the Senate's all-inclusive
language ("if the activity . . . involves fraud in the sale of securi-
ties"), but the more ambiguous "would have been actionable as
fraud in the purchase or sale of securities" wording that emerged
from the conference committee. Senator Biden's amendment,
though, made the final cut and the next sentence in the amend-
ment allows civil securities suits if the defendant has already
been criminally convicted. Finally, § 108 of the PSLRA contains a
"savings clause" that applies to all of the litigation reforms con-
tained in the bill. The clause indicates that any actions that pre-
dated passage of the Act would not be affected: "The amend-
ments 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, commenced before and
pending on the date of enactment of this Act."\textsuperscript{39}

II. JUDICIAL INTERPRETATIONS

The question of the preclusive effect of the PSLRA amend-
ment on RICO has produced a split among federal courts.\textsuperscript{40} The
courts do not acknowledge the split, but a close analysis of the
cases reveals a distinct methodological trend, with courts falling
neatly into two camps.
With rare exception, judges have found that the amendment blocks RICO claims at bar from proceeding, but the methods judges use to reach that conclusion fall into two categories: first, finding the amendment to be absolutely preclusive of any securities fraud actions, or, second, determining whether the claims would have been otherwise “actionable.” In other words, the real dispute among judges seems to lie in how the claims are evaluated for preclusive scope: is the role of the court to scan the pleadings for anything that looks and smells like securities fraud, or is it to test the claim’s viability under various legal theories to see if it is, in fact, actionable under existing securities laws? Three circuit courts have found the PSLRA amendment to be absolutely preclusive. Two circuit and several district courts have instead required what I have dubbed an “actionability analysis.” These methodological differences are described below.

Like the political actors who debated the PSLRA amendment, judges evaluating its scope are divided into two groups (though not along the same politically-drawn lines as their legislative predecessors). In one camp are the Second, Third, and Ninth Circuits, which read the PSLRA amendment to be absolutely preclusive: any pleading that contains a claim sounding in

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41 See, for example, Rezner v Bayerische Hypo-Und Vereinsbank, 630 F3d 866 (9th Cir 2010) (affirming a district court’s finding that the PSLRA amendment did not bar a RICO pleading that included securities and non-securities claims); Petters Co v Stayhealthy, Inc, Fed Secur L Rptr (CCH) P 92,856 (Minn 2004) (allowing a plaintiff leave to amend a RICO complaint because defendant did not adequately demonstrate that the claims would not have been actionable by any plaintiff).

42 See MLSMK Investments v JP Morgan Chase, 651 F3d 268 (2d Cir 2011); Howard v America Online, 208 F3d 741 (9th Cir 2000); Bald Eagle, 189 F3d 321.

43 See, for example, Affco, 625 F3d 185; Bixler v Foster, 596 F3d 751 (10th Cir 2010); Ouwinga v John Hancock, 2010 WL 4386931 (WD Mich); Payton v Flynn, 2006 WL 3087075 (ND III); Hollinger v Hollinger, Fed Secur L Rptr (CCH) P 93,012 (ND III 2004); Petters, Fed Secur L Rptr (CCH) P 92,856.

44 This Comment omits from discussion a second, intertwined issue. Courts have been unable to reach a consensus about how to sort litigants. If a claim “would have been actionable as fraud in the purchase or sale of securities” for one plaintiff, it is uncertain whether that precludes all other plaintiffs from bringing the same claim as part of a RICO action, regardless of their lack of standing. Another sticking point for judges evaluating the operation of the PSLRA amendment on civil RICO has been retroactivity. Several courts have addressed the issue of the amendment’s temporal scope. See, for example, Popp Telecom v American Sharecom, 361 F3d 482 (8th Cir 2004); Scott v Boos, 215 F3d 940 (9th Cir 2000); Mathews v Kidder, 161 F3d 156 (3d Cir 1998); Shaw v Mancuso Inv Corp, 2004 WL 793469 (ND Ill); Scott v Steingold, 1998 WL 704287 (ND Ill). This issue is not addressed here, as it has been more than adequately discussed elsewhere. See, for example, Todd A. Noteboom and Michael A.G. Korengold, Nunc Pro Tunc: The Application of the Private Securities Litigation Reform Act of 1995 to Pending Civil RICO Claims Based on Securities Fraud, 23 Wm Mitchell L Rev 565 (1997).
securities fraud is barred on its face. This approach is set forth in Part IIA below. In the other camp are the Fifth and Tenth Circuits and several federal district judges. These courts perform an “actionability analysis” when determining whether a claim is precluded: the plaintiff may move forward if she could not have otherwise sought a legal remedy. This approach is described in Part IIB below.45 Particular attention is paid to the justifications offered by judges using each methodological approach. Some subscribe to one methodology over another in a purely unexamined move, while others point to text, legislative history, or other indices to justify their positions.

A. Absolute Preclusion

The circuit court opinions described below are laid out in chronological order—that is, by the date on which they ruled on the preclusive effect of the PSLRA amendment to RICO: the Third Circuit in 1999, the Ninth Circuit in 2000, and, most recently, the Second Circuit in 2011. Following the discussion of these circuit court decisions is a review of some district court opinions issued in circuits wherein the courts of appeals have not yet ruled on the issue.

The first federal court of appeals to rule on the preclusive effect of the PSLRA amendment on RICO was the Third Circuit, and many later courts have adopted that court’s reasoning. In Bald Eagle School District v Keystone Financial,46 the court considered a class action brought by public school districts that lost $70 million in a Ponzi investment scheme constructed by John Gardner Black.47 Black was criminally convicted and faced an SEC civil action, but this suit was directed at Mid-State Bank, which held Black’s investment accounts. The plaintiff school districts alleged that the bank had every reason to know that Black’s funds fell short of collateral requirements and even actively concealed the fact from investors and regulators.48

45 The First, Fourth, Sixth, Seventh, Eighth, and Eleventh Circuit Courts have not yet ruled on this issue.
46 189 F3d 321 (3d Cir 1999). See also Mike Buckso, Grand Jury Indicts Black; Financier Accused of Orchestrating State’s Largest Municipal Fraud, Pittsburgh Post-Gazette at A-13 (June 19, 1999). In an earlier case, the Third Circuit ruled on the retroactivity of the PSLRA amendment and its analysis in dicta tended toward absolute preclusion. See Mathews, 161 F3d at 157 (indicating that the PSLRA amendment eliminated from RICO actions “any conduct actionable as fraud in the purchase or sale of securities”).
47 Bald Eagle, 189 F3d at 323.
48 See id at 326. See also Marylynne Fitz, Suit Says Bank Helped Conceal Losses;
Judge McKee, writing for a unanimous Third Circuit panel, affirmed the lower court’s dismissal of the suit on the grounds that it was absolutely precluded by the PSLRA amendment to RICO. McKee pointed to the ongoing SEC action against Black. If the SEC was involved, then the crux of the case was about securities fraud. Securities fraud was securities fraud, so the action could not proceed. Judge McKee explained:

[T]he SEC has alleged that a massive Ponzi scheme was perpetrated through the purchase and sale of CIAs in violation of the securities laws including § 10(b) of the Securities Exchange Act of 1934, and SEC Rule 10b-5 and other provisions of the securities law. . . . That same Ponzi scheme is at the heart of this RICO action.49

McKee provided little in the way of justification for taking an absolutely preclusive approach. He merely included a few statements made by PSLRA sponsor Cox to stand for the proposition that the RICO amendment was aimed at “completely eliminating the so-called ‘treble damage blunderbuss of RICO’ in securities fraud cases.”50 His analysis on this point went no further.51

Even courts that perform an actionability analysis, though, frequently cite the move McKee made next. The school district plaintiffs contended that their complaint should proceed because, though it could be construed as securities fraud, it also constituted bank, mail, and wire fraud. The court held that such maneuvers simply constituted ways for plaintiffs to avoid the PSLRA bar with artful pleading. “[A] plaintiff cannot avoid the RICO Amendment’s bar by pleading mail fraud, wire fraud, and bank fraud as predicate offenses in a civil RICO action if the conduct giving rise to those predicate offenses amounts to securities fraud.”52 Pointing to statements made in the House of Repre-

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49 Bald Eagle, 189 F3d at 328. See also 15 USC § 78j; 17 CFR § 240.10b-5 (“SEC Rule 10b-5”). The “CIAs” mentioned by Judge McKee are “Collateralized Investment Agreements,” financial instruments which can guarantee a fixed rate of return but usually require collateral equal to 100% of the principal invested.


51 Bald Eagle was followed by several district decisions in the Third Circuit, including: Gatz v Ponsoldt, 297 F Supp 2d 719 (D Del 2003); Burton v Ken-Crest Servs, 127 F Supp 2d 673 (ED Pa 2001); and Ravenna v Integrated Food Techs Corp, 1999 WL 740384 (ED Pa).

52 Bald Eagle, 189 F3d at 329–30.
sentatives about building high barriers to the use of mail and wire fraud pleadings to allege securities fraud, the opinion proceeded: “[a]llowing such surgical presentation of the cause of action here would undermine the congressional intent behind the RICO amendment.”

This distinction—between securities fraud masked as mail and wire fraud on the one hand and unabashed securities fraud on the other—reappears continually in subsequent PSLRA-RICO jurisprudence.

The next circuit court of appeals to address the scope of the PSLRA amendment to RICO read the language even more broadly. In *Howard v America Online*, the Ninth Circuit handily dismissed a RICO claim sounding in securities fraud in five short paragraphs. Like the *Bald Eagle* court, the *Howard* court looked at the substance of the claims—misrepresented profits, improper accounting practices, and illegal stock sale—and found that they all appeared to concern securities and were therefore barred. Citing no authority but the text of the statute, the court concluded that actions that looked like securities fraud were per se precluded.

The *Howard* court did not stop there. In response to the plaintiff class’s contention that they would not have had standing under federal securities laws to bring the listed actions, the

53 Id at 330.

54 This Comment omits from discussion the arguments judges have made about the interdependence of claims. Because RICO cases must, by design, rest upon a string of claims alleging a pattern of predicate acts, the courts have not resolved the question of what happens when *some* but not *all* of the predicate acts are explicitly barred by the PSLRA amendment. Interdependent claims in these cases feature three different types of relationship. The first type of claim interdependence involves securities and non-securities claims that revolve around the same core facts. See, for example *Bixler*, 596 F3d 751; *Armstrong v American Pallet Leasing Inc*, 678 F Supp 2d 827 (ND Iowa 2009); *Eagletech Communications Inc v Citigroup, Inc*, 2008 WL 3166533 (SD Fla); *Bald Eagle*, 189 F3d at 329–30; *Krear v Malek*, 961 F Supp 1065 (ED Mich 1997). The second type of claim relationship centers upon claims to which securities are only tangentially related. See, for example, *Rezner*, 630 F3d at 871–72; *Petters, Fed Secur L Rptr (CCH)* P 92,856 at *10. The third category of interdependent-claim relationships are those in which some non-securities claims could, in theory, survive the PSLRA amendment even if some accompanying predicate acts could not. See, for example, *Florida Evergreen Foliage v El du Pont de Nemours & Co*, 165 F Supp 2d 1345, 1358 (SD Fla 2001); *Ling v Deutsche Bank*, 2005 WL 1244689, *15 (SDNY). But see *Jacoboni v KPMG*, 314 F Supp 2d 1172, 1185 (M Fla 2004) (“The statute does not bar a RICO claim whenever someone could assert a securities fraud claim arising from a given relationship. Rather, the bar only relates to reliance, as a basis for the RICO claim, on specific conduct ‘actionable’ as securities fraud.”).

55 208 F3d 741, 749–50 (9th Cir 2000).

56 Id.

57 Id at 749.

58 Id.
court, again citing only the statute itself, countered that the distinction was immaterial. The statute, after all, only prohibited claims that “would have been actionable.” It did not specify by whom the claims would be actionable. If any plaintiff could have brought the case, in other words, then the plaintiff class could not, even if the individual plaintiffs or the entire class lacked standing.\footnote{Howard, 208 F3d at 749–50.} Courts outside of the Ninth Circuit often cite Howard for this proposition.\footnote{See, for example, Payton, 2006 WL 3087075 at *21.}

The Ninth Circuit reaffirmed Howard’s absolutely-preclusive reading of the PSLRA amendment to RICO six years later. In Powers \textit{v} Wells Fargo,\footnote{439 F3d 1043 (9th Cir 2006).} the court, depending again on only a judicial interpretation of the text, clarified that the RICO amendment blocked all suits, not just class actions.\footnote{Id.} The following year, in Swartz \textit{v} KPMG,\footnote{476 F3d 756 (9th Cir 2007).} the court again briefly reviewed a set of facts for evidence that they involved securities fraud, and, citing no authority, found that the PSLRA bar applied.\footnote{Id.} The court affirmed the lower court’s dismissal with prejudice: “Because the PSLRA bar would apply under any internally consistent set of facts, it would be futile to amend the RICO claim.”\footnote{Id at 761.}

Perhaps the strongest version of absolute preclusion arose from the Second Circuit in 2011. Indeed, the Second Circuit and its Southern District of New York court have been at the epicenter of the debate over the meaning of the “would have been actionable” language, most likely because so many securities disputes arise within a five-mile stretch of Manhattan. In MLSMK Investments \textit{v} JP Morgan Chase,\footnote{651 F3d 268 (2d Cir 2011).} the court of appeals considered the complaint of victims of Bernard Madoff’s massive Ponzi scheme. In facts similar to those in Bald Eagle, the investors\footnote{For more on Madoff’s Ponzi scheme and its unraveling, see, for example, Amir Efrati, Tom Lauricella, and Dionne Searcey, Top Broker Accused of $50 Billion Fraud—Sons Turned In Madoff After He Allegedly Told Them His Investment-Advisory Business for the Wealthy Was “Giant Ponzi Scheme,” Wall St J A1 (Dec 12, 2008); Tom Lauricella, Amir Efrati, and Jenny Strasburg, The Madoff Fraud Case: Examiners at SEC Sift Through Years of Records, Wall St J A7 (Dec 13, 2008); Diana B. Henriques and Jack Healy, Madoff Jailed after Pleading Guilty to Fraud, NY Times A1 (Mar 13, 2009).}

\footnote{MLSMK Investments is a partnership based in Palm Beach, Florida. It appears to be an investment fund for Marilyn L. and Stanley M. Katz, a couple residing in Palm...}
alleged that the defendant bank conducted an internal investigation into Madoff’s business. Realizing that his reported returns were false and illegitimate, the bank pulled some of its Madoff positions without warning other customers, whose funds remained under his management. JP Morgan Chase, moreover, continued to reap lucrative fees from Madoff’s other business.68

Beach and in Purchase, New York. Mr. Katz is a lawyer and real estate developer. The Katzes appear to be avid philanthropists, donating frequently to cancer research, elder care, and their native Bronx neighborhood. See, for example, Albert Einstein College of Medicine Press Release, Albert Einstein College of Medicine Receives $7-Million Dollar Gift to Create a Cancer Prevention Program (Feb 7, 2006), online at http://www.einstein.yu.edu/home/news.asp?id=168 (visited Sept 10, 2012). What appears to be Mr. Katz’s Martindale record is available online at http://www.martindale.com/Stanley-M-Katz/666231-lawyer.htm (visited Sept 10, 2012).

68 MLSMK, 651 F3d at 271–72. According to the investors’ complaint, JP Morgan Chase (JPMC) was, in fact, central to the success of Madoff’s scheme. The bank was entangled with Madoff’s investments in three critical ways: first, it provided banking and depository services; second, it garnered Madoff legitimate market-making revenue; and, third, it devised a derivative instrument driven by Madoff’s success. Per the plaintiffs, Madoff had deposited all of his investors’ funds with JPMC since 1992. See Complaint, MLSMK Investments v JP Morgan Chase, Civil Action No 09-CV-4049, *10 (SDNY filed Apr 23, 2009) (available on Westlaw at 2009 WL 1246206) (“MLSMK Complaint”). Moreover, when JPMC acquired Bear Sterns in 2008, it inherited the latter company’s unorthodox relationship with Madoff. See J.P. Morgan Quintuples Bid to Seal Bear Deal, Wall St J A1 (Mar 25, 2008). Since 2000, Bear Sterns had designated Madoff as its default market maker for all electronic equity trades, netting Madoff millions annually in bid-asked spread profits, one of Madoff’s few legitimate sources of revenue. MLSMK Complaint at *5–9. A “market maker” is an institution or investor who serves as an intermediary between buyers and sellers of a security. Investors compensate the market maker for the risk associated with playing this intermediary role by paying a higher price to purchase (“bid”) than to sell (“ask”). The difference between the price the market maker may demand for the security and the price she must pay for it on the market is called the “bid-asked spread.” For an introduction, see Stephen J. Choi and A.C. Pritchard, Securities Regulation: Cases and Analysis 12–16 (Foundation 2d ed 2005). The third JPMC-Madoff entanglement, though, was the one the plaintiffs highlighted. According to the complaint, the Fairfield Greenwich Group (FFG) served as one of Madoff’s “feeder funds,” or independent investment companies that funneled most of their investors’ money into Madoff’s operation. MLSMK Complaint at *15–16. See also Securities Investor Protection Corporation v Bernard Madoff Investment Securities, 454 BR 285, 290–92 (Bankr SDNY 2011) (describing the feeder funds as entities wherein customers invested money, which fund managers in turn invested in Madoff’s company). Surprisingly, Madoff trustee Irving Picard attempted to sue FFG, as the fund was a so-called “net winner,” or one of the lucky few Madoff investors who managed to extract more than it had invested. See Jonathan Stempel, Madoff Judge: Feeder Fund Investors Cannot Recover (Reuters June 28, 2011), online at http://www.reuters.com/article/2011/06/28/us-madoff-feederfunds-idUSTRE75R6A320110628 (visited Sept 10, 2012). FFG held more than half of its $14.5 billion under management in its “Sentry Fund,” which it invested with Madoff. MLSMK Complaint at *15 (alleging that the Sentry Fund invested 95 percent of its cash with Madoff’s investment company, Bernard Madoff Investment Securities). In 2006, JPMC began offering to its customers a note that paid three times the earnings in the Sentry Fund. Id at *16. In other words, as Madoff went, so went the notes of the Sentry Fund. Id. In effect, then, the bank had created a derivative whose success hinged entirely upon Madoff’s. When Madoff continued to report healthy returns in the Sentry Fund in the midst of the financial crisis
The court took the argument that the case sounded in securities fraud for granted. The opinion gives no space to discussions of whether the case as a whole was precluded. Instead, the Second Circuit focused the inquiry on the question addressed in Howard: was a securities fraud claim “actionable” and thereby precluded even if the given plaintiff would not have had standing to pursue it? In this case, the plaintiffs alleged that the bank aided and abetted Madoff in his fraud, but private litigants do not have a cause of action for aiding and abetting under the federal securities laws. No private litigant could have pursued this case, though the SEC would have had the requisite standing.

Citing the text and legislative history of the PSLRA amendment, the court determined that the claim was nonetheless precluded. Specifically, the Court made much of language in the

of 2008, a suspicious JPMC launched an internal investigation into his operation. The bank then quietly and abruptly pulled the $250 million it had invested in the Sentry Fund. JPMC made no alterations to its relationship with Madoff, nor did it notify the triple Sentry Fund note holders—whose instruments were worthless if the Fund did not generate any real earnings—of the results of the investigation. Id. JPMC described the decision to investigate Madoff and liquidate their Sentry Fund position as standard operating procedure, citing a “lack of transparency” in Madoff’s operation. Robert Chew, Madoff’s Banker: Where was JP Morgan Chase? (Time Mar 25, 2009), online at http://www.time.com/time/business/article/0,8599,1887338,00.html (visited Sept 10, 2012) (quoting Chase spokeswoman Kristin Lemkau). Madoff investors, though, painted a far more sinister picture of a financial institution that wanted to retain the hefty fees Madoff’s business generated all the while knowing that his reported returns were fraudulent. MLSMK Complaint at *18–20. Plaintiff MLSMK Investments alleged that it lost $12.8 million in Madoff’s scheme and that JPMC, after conducting its investigation, knew that Madoff’s statements about his success were false. In other words, MLSMK, though they were not directly involved with the Sentry Fund or its associated note and derivative, argued that JPMC injured all Madoff investors by not revealing their suspicions about his earnings and by allowing Madoff to continue to conduct his business. At trial, JPMC raised the issue of PSLRA preclusion of MLSMK’s RICO claims, but the district court judge focused instead on MLSMK’s speculative pleading, dismissing the case for failure to adequately demonstrate scienter. MLSMK Investment v JP Morgan Chase, 737 F Supp 2d 137, 142–43 (SDNY 2010).

69 MLSMK, 651 F3d at 276. The Second Circuit’s attitude toward “vicarious plaintiffs” points to another point of contention among federal courts, who have strained to determine by whom a claim “would have been actionable as fraud in the purchase or sale of securities.” In other words, does the statute describe all plaintiffs who could potentially bring a securities fraud case, or just this one? The early Ninth Circuit case of Howard set the tone for answering this question. Citing only the statute itself, the court determined that the disputed claims “could be brought by a plaintiff with proper standing,” and therefore were precluded. Howard, 208 F3d at 749. Most subsequent courts to address the issue of vicarious plaintiff preclusion—that is, the idea that, if an absent plaintiff could bring the claim, it is precluded—have taken the Howard approach. See, for example, Afco, 625 F3d 185; Hollinger, Fed Secur L Rptr (CCH) P 93,012. In MLSMK, the Second Circuit widened the pool of vicarious plaintiffs who could preclude an action: even if no private litigant could conceivably bring suit, so long as the SEC could, the claim was “actionable.” MLSMK, 651 F3d at 276. See also Amos v Franklin Financial Services, 2011 WL 5903875, *13 (MD Pa). The decisions overturned by MLSMK had seen the issue differently. In OSRecovery v One Groupe, 354 F Supp 2d 357 (SDNY 2005), Judge Kaplan of
PSLRA Conference Committee report that emphasized that the PSLRA would "eliminate securities fraud as a predicate offense in a civil RICO action," and eliminate "any conduct that would have been actionable as fraud in the purchase or sale of securities." The Court interpreted this "any conduct" wording to implicate an absolutely preclusive reading, though it did not speculate about the meaning of the "would have been actionable" language. The decision resolved a district court split that had grown in the Second Circuit, and overturned at least three district courts.

In some of the circuits in which the appeals courts have yet to rule specifically on the preclusive scope of the RICO amendment, district courts asked to address that issue have been persuaded by the absolute preclusion method. In the Seventh, Eighth, and Eleventh Circuits, district courts dismissed RICO claims sounding in securities fraud because the complaints appeared to be about securities fraud. These courts, like the circuit courts of appeals described above, did not inquire into whether the "would have been actionable" language required a narrower reading or further analysis.

To synthesize some of the decisions described above, the absolutely preclusive methodology possesses indicative characteristics. In Bald Eagle, for instance, the existence of an SEC action regarding the matter—even though it was aimed at a different defendant—was dispositive. A judge that ascribes to the absolutely preclusive methodology, then, may find that a PSLRA-RICO analysis ends as soon as he or she discovers that the SEC
is investigating the matter in some capacity, even if the existing investigation pertains to separate parties. Absent a tell-tale SEC action, judges engaging in absolutely preclusive analyses may also review the facts in search of transactions that look like securities sales (as occurred in Howard). Judges in these cases are likely to find that the PSRLA bar also applies to claims not explicitly labeled as securities fraud but pertaining to the same set of facts and injuries as would a securities fraud claim.

In summary, the indices of an absolutely preclusive analysis include the following:

- an inquiry into whether the SEC is investigating the matter (Bald Eagle);
- a cursory review of the facts for transactions or instruments that "look like" securities (Howard); and
- a determination of whether some of the claims made could, in the alternative, be pleaded as securities fraud (the Bald Eagle "surgical presentation" inquiry).

Some of the justifications offered by courts subscribing to an absolutely preclusive approach are summarized as such: the justification offered in Bald Eagle was an interpretation of partisan statements made by PSLRA sponsor Christopher Cox;\textsuperscript{76} Howard relied upon a judicially performed textual analysis and no citations to authority;\textsuperscript{77} finally, Swartz demonstrates the most unexamined commitment to an absolutely preclusive reading, in the form of a strong bar to securities fraud claims and no citations to authority of any kind.\textsuperscript{78}

B. Actionability Analysis

The district courts in all of the circuits that have yet to rule on the method of determining preclusion are by no means monolithic. Some courts argue for absolute preclusion and others present actionability analyses. This was the way the Second Circuit looked before MLSMK in 2011. Though the MLSMK court was unconvinced by the reasoning of the district courts it overturned, the actionability analysis has found some traction elsewhere. The

\textsuperscript{76} Bald Eagle, 189 F3d at 327–28, citing 141 Cong Rec H2771 (Mar 7, 1995) (statement of Representative Cox).

\textsuperscript{77} Howard, 208 F3d at 749.

\textsuperscript{78} Swartz, 476 F3d 756.
cases described below fall into this category. In this section, the circuit court opinions—from the Fifth and Tenth Circuits—precede district court opinions in circuits that have not yet ruled on the issue.

By “actionability analysis,” I mean an inquiry into whether the claim “would have been actionable” under existing securities laws. Courts who perform this process scour the language of relevant securities law provisions and case law to determine if the litigants' claims are otherwise actionable. In other words, these courts start with the statutes and then analyze the fact pattern. This approach contrasts with the “absolute preclusion” analysis outlined above, where courts first review the facts for evidence that a litigant is pleading securities fraud and end the analysis if the complaint appears to be centered upon securities fraud issues. The opinions discussed below developed this minority approach to judicial methodology.

An example of an actionability analysis can be found in *Affco Investments v Proskauer Rose.* 7 In *Affco*, the Fifth Circuit Court of Appeals reviewed a RICO complaint in which investors who participated in an elaborate tax shelter later faced audits and penalties assessed by the IRS. In this case, the plaintiffs alleged that the defendant law firm, Proskauer Rose, had erroneously advised them that the tax shelter was both legitimate and legal. Proskauer countered by arguing that the Limited Liability Company (LLC) interests the plaintiffs bought as part of the tax evasion scheme were securities and that the complaint was therefore a precluded securities fraud action.80

The court then proceeded through a lengthy analysis to determine whether the LLC interests were, in fact, securities as defined by federal law. The first step was to speculate that the tax evading instruments may have constituted “investment contracts” under the Securities Act.81 The court then turned to the Supreme Court's 1946 case, *SEC v Howey,*82 which outlined the criteria that make an instrument an “investment contract.”83 The *Affco* court then applied this test to the set of facts in the Pros-

79 625 F3d 185 (5th Cir 2010).
80 Id at 189–90.
82 328 US 293 (1946).
83 Id.
kauer tax evasion scheme and where there was ambiguity, turned to case law interpreting the Securities Act. Ultimately, the court determined that the LLC interests were securities and that the claims were otherwise actionable and therefore barred, but its analysis looks radically different from the ones performed in Bald Eagle, Howard, and MLSMK. The court did not offer an explicit justification for its actionability methodology, but the trigger seemed to be the presence of the word “securities” in the PSLRA amendment, a word whose interpretation has generated a great deal of case law.

The actionability approach to the PSLRA amendment has taken root elsewhere. In Bixler v Foster, the Tenth Circuit focused its inquiry into the amendment’s preclusive scope on the phrase “purchase or sale of securities” found in the amended version of RICO. Again, as in Affco, the “trigger” for engaging in an actionability analysis was the presence of statutory words that

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84 Affco, 625 F3d at 191.
85 A lower court in the Fifth Circuit followed Affco in Conwill v Greenberg Traurig, 2011 WL 1103728 (ED La). This district court case concerned yet another investor who trusted the guidance of others and participated in a fraudulent tax shelter. As the court of appeals had in Affco, the Conwill judge presented the “investment contract” test, then worked the facts through the criteria presented in Howey and its successor cases and finally concluded that the claims “would have been actionable” as securities fraud. Id at *16–18. Conwill then addressed the Bald Eagle problem created by plaintiffs who plead securities fraud as mail or wire fraud. The district court did not dismiss these claims out of hand as deceptive pleading the way an absolute preclusion court would have. Instead, the court demonstrated through a second actionability analysis that the mail and wire fraud claims “would have been actionable” under SEC Rule 10b-5 and were therefore precluded by the PSLRA amendment. Id at *18–20.
86 596 F3d 751 (10th Cir 2010). The Bixler plaintiffs were minority shareholders of a New Mexico uranium mining concern, Mineral Energy and Technology Corporation (METCO). Id at 754–55. Three of the company’s directors (who were also majority shareholders) also served on the board of an Australian mining company, Uranium King. The METCO directors negotiated a “merger” that would transfer METCO’s primary assets to Uranium King in exchange for shares of Uranium King and cash. The Australian company never paid, but “abandoned” the merger after accepting METCO’s mining claims, rendering the New Mexico company virtually worthless. Id. The transaction, in other words, was a wash for the defendant directors, who could enjoy the value of the mining claims whether METCO or Uranium King held them. METCO’s minority shareholders, though, now held stakes whose value had been greatly reduced. Plaintiff minority stakeholders alleged that the transaction constituted an illegitimate “enterprise” under RICO, also naming the directors’ attorneys as defendants. Id. For the lower court’s equally terse treatment of the case, see Bixler v Foster, No CIV 08-676 MCA/DJS, slip op (D NM Mar 31, 2009). Judge Tymkovich, drawing on Supreme Court mergers and acquisition case law, found that the METCO-Uranium King transaction involved the sale of securities and was actionable and that the plaintiffs were therefore precluded from pursuing a RICO action against the defendant directors. Bixler, 596 F3d at 760.
87 PSLRA § 107, 109 Stat at 758, codified at 18 USC § 1964(c) (“[N]o 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.”).
had been interpreted at length elsewhere. In an analysis more abbreviated than the one found in Affco, Judge Tymkovich of the Tenth Circuit determined that a transaction of the type in dispute constituted a “purchase or sale” for the purposes of the federal securities laws.88

The unwary Bixler plaintiffs fell into the same trap as the Bald Eagle school districts: they tried to argue that most of the predicate acts they alleged constituted mail or wire fraud, though they could also have been pleaded as securities fraud. Like the Third Circuit court before it, the Tenth would not allow such a “surgical presentation” of the case.89

The Sixth Circuit Court of Appeals has yet to rule on the preclusive effect of the PSLRA amendment on RICO, but district courts in that circuit have employed the actionability analysis. In Ouwinga v John Hancock, 90 the district judge declined a defendant’s motion to dismiss, which alleged that plaintiffs’ claims were barred by the PSLRA amendment.91 The court evaluated Rule 10b-5 jurisprudence and found that the facts as presented were not precluded. Reading the PSRLA-amended RICO statute’s inclusion of securities fraud to implicate Exchange Act Rule 10b-5, Judge Neff of the Western District of Michigan determined that, to constitute precluded securities fraud, the allegedly fraudulent conduct had to have occurred “in connection with” the purchase or sale of securities, a selection from the text of Rule 10b-5 that has sprouted its own interpretive jurisprudence.92 This analytical move enabled the judge to graft the substantial 10b-5 case law onto the resolution of the still unsettled PSRLA-RICO question. As justification for this approach, the Court contended that “actionable” securities fraud claims derived from the 1934 Act and that, as a rule, PSLRA-RICO questions should begin with the existing case law.93

88 Bixler, 596 F3d at 760, citing Realmonte v Reeves, 169 F3d 1280, 1285 (10th Cir 1999) (“When an exchange of shares facilitates the merger of two separate and distinct corporate entities, that exchange constitutes a ‘purchase or sale’ for purposes of bringing a Rule 10b-5 action.”). See also SEC v National Securities, 393 US 453 (1969). Case doctrine on the meaning of the “purchase or sale” language is consistent with the Supreme Court’s holding in Landreth Timber v Landreth, 471 US 681 (1985).
89 Bixler, 596 F3d at 760.
91 Id at *17–18.
92 Id. See also Exchange Act Rule 10b-5, 17 CFR § 240.10b-5 (deeming it illegal to employ a manipulative or deceptive device “in connection with the purchase or sale of any security”).
93 Ouwinga, 2010 WL 4386931 at *15.
Ultimately, the Western District of Michigan court held that the fraud in question was not precluded, rendering *Ouwinga* a rarity in PSLRA-RICO jurisprudence. Because the court determined that the securities at play in the case were not pivotal to the fraudulent transaction, the fraud alleged was not "in connection with" the purchase or sale of securities and the claims were therefore not "actionable" and not precluded by the PSLRA. In effect, Judge Neff faulted the defendants for not performing an actionability analysis of their own: "Defendants have failed to persuade the Court on the present record that the conduct at issue would be actionable as securities fraud. This is particularly so because defendants offer no analysis or specific authority under which plaintiffs could proceed with a cause of action for securities fraud." A later case in the Eastern District of Michigan replicated the Western District's actionability analysis by reviewing various standards judges have used to assess Rule 10b-5 claims, and, particularly, the "in connection with" language.

Versions of the actionability analyses described above have cropped up elsewhere. In the divided Seventh and Eighth Circuits, courts have assessed whether claims "would have been actionable" using indices not seen in other circuits. Though the Eleventh Circuit Court of Appeals has conceded that "the statute can be read two ways and there is no published case law directly on point," some district courts in the Eleventh Circuit have opted for the actionability approach.

Again, a synthesis of some of the reasoning provided in the cases described above forms a cohesive methodological pattern. Courts undertaking an actionability analysis hand down opinions possessing one or more indicative characteristics. *Affco*, for instance, features the *SEC v Howey* test for determining whether

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94 See text accompanying note 41.
96 Id (emphasis added).
98 For examples of Seventh Circuit actionability cases, see Payton, 2006 WL 3087075; *Hollinger*, Fed Secur L Rptr (CCH) P 93,012. In an actionability analysis parallel to *Bald Eagle*, the *Hollinger* court found that a case "would have been actionable" if another plaintiff class were pursuing the same claims elsewhere. For an example of an Eighth Circuit actionability case, see *Petters*, Fed Secur L Rptr (CCH) P 92,856.
100 See, for example, *Smith v Copeland*, Fed Secur L Rptr (CCH) P 95,750 (ND Ga); *Cook v Campbell*, 482 F Supp 2d 1341 (MD Ala 2007).
an instrument is a security. This fundamental question—which implicates a body of Supreme Court tests for determining whether security laws even apply to the transaction—is likely to appear in an actionability opinion. Bixler's focus on the “purchase or sale” language in the amended statute gives a judge inclined toward the actionability approach another test, and another opportunity to “short-hand” analysis, by pointing to extensive case law. Judges also have ample Rule 10b-5 jurisprudence at their disposal if they choose to follow the Ouwinga reasoning and query whether the fraud alleged occurred “in connection with” the purchase or sale of securities. Finally, an actionability analysis may include some indication as to where the burden of proving actionability (or non-actionability) lies; Ouwinga is the only case in the PSLRA-RICO canon to explicitly identify a party responsible for demonstrating actionability (in that case, the defendant).

In summary, the indices of an actionability analysis include any of the following:

- an inquiry into whether the instrument or transaction in question is a security, citing SEC v Howey and subsequent Supreme Court doctrine (Affco);
- an analysis of whether the transaction in question involves the “purchase or sale” of securities (Bixler);
- a determination of whether the alleged fraud occurred “in connection with” the purchase or sale of securities (Ouwinga); and
- an allocation of the burden of proving whether a claim is actionable (Ouwinga).

Though the fact patterns and actionability indices may vary, the method is essentially the same across the circuits: start with the rules for what constitutes an “actionable” securities fraud claim and then hold the alleged facts up against them. The claims are only precluded by the PSLRA bar if they “would have been actionable” under existing securities laws.

III. A NARROW READING IN THE FORM OF AN ACTIONABILITY ANALYSIS BETTER FULFILLS THE PURPOSE OF THE PSLRA AMENDMENT

The remainder of this Comment sets forth an argument for why practitioners and courts should read the PSLRA amendment
to RICO and its ambiguous "would have been actionable" language narrowly. A narrow reading takes concrete form in the actionability analysis—the second methodology, described in Part IIB above—which enables courts to ensure that plaintiffs with vindicable claims may proceed beyond the pleading stage. As demonstrated in the review of opinions in Part II, the choice of methodology may have little impact on the outcome of the case, but the more cautious and thorough actionability approach may have the marginal effect of periodically allowing meritorious RICO actions to proceed where an absolutely preclusive bar would have blocked them. In Part IIIA below, I demonstrate how the textual structure and legislative history of the PSLRA amendment lend themselves to an actionability reading. In Part IIIB, I argue that the narrow reading also leads to desirable jurisprudential outcomes: contained error costs and adherence to canons of construction.

A. The Textual Structure and Legislative History of the PSLRA Point to a Narrow Reading

A striking omission from the reasoning offered by courts in PSLRA-RICO cases is a discussion of the structure and order of the text in the final version of the PSLRA, which points toward a narrow reading. Section 108 of the statute, which appears immediately after the RICO amendment, contains a "savings clause" that specifies that the statute does not alter suits pending at the date of enactment. This section reads, in relevant part, "[t]he 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.\(^{101}\) The specific enumeration of the two federal securities statutes and their implied private rights of action indicates the existence of a closed set of actions.

In other words, if one part of the PSLRA (§ 108) specifies that the amendments pertain to enumerated statutory actions, it seems unlikely that the immediately preceding part (§ 107) would refer to a vague, far-reaching category of actions that "look like" securities fraud, as the absolutely preclusive reading would suggest. The articulation in § 108 of relevant statutes suggests that the enacting Congress had actions arising under the 1933 and 1934 Acts in mind when it included the word "securities."

If the amendment is meant to preclude actions arising under the two primary federal securities statutes, then testing the preclusive scope of the provision should start with an inquiry into whether the claims are actionable under the 1933 and 1934 Acts, as occurred in *Affco*, *Ouwinga*, and *Bixler*. In those cases, judges were prompted by “trigger” words and phrases to look to existing securities case law for answers. This approach is consistent with the Supreme Court’s *in pari materia* canon of construction, which dictates that a court may interpret ambiguous language in a later act using interpretations of an older act when the two statutes deal with precisely the same subject matter.

Moreover, many of the courts that have ruled on the preclusive scope of the PSLRA amendment have pointed to legislative history, but only to statements about broad purposes animating the legislation or to partisan statements made by sponsors. For instance, in *Bald Eagle*, the Third Circuit cited the general proposition Representative Cox stated when proposing the RICO amendment: the preclusion was designed “to address a significant number of frivolous actions based on alleged securities law violations.” In other words, courts invoking the legislative history of the PSLRA amendment regard statements made by individual representatives to be dispositive, though the Supreme Court has generally found such politically-charged statements to be unreliable indications of legislative intent.

What these courts have overlooked is the bill’s enactment history, which points toward a narrow reading, and particularly an actionability analysis. The version of the amendment to

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102 See text accompanying notes 79-100.
103 See, for example, *US v Stewart*, 311 US 60, 64 (1940).
104 For Supreme Court authorization for the use of legislative history in statutory interpretation, see generally *Church of the Holy Trinity v United States*, 143 US 457, 459 (1892) (advocating for judicial consideration of “the whole legislation, or of the circumstances surrounding its enactment” when text is ambiguous); *United Steelworkers v Weber*, 443 US 193, 201 (1979) (encouraging judges to read a statute “against the background of the legislative history of [the statute] and the historical context from which” it arose).
106 See, for example, *Consumer Product Safety Commission v GTE Sylvania*, 447 US 102, 118 (1980) (“[O]rdinarily [] the contemporaneous remarks of a single legislator who sponsors a bill are not controlling in analyzing legislative history.”); *Chrysler v Brown*, 441 US 281, 311 (1979) (“The remarks of a single legislator, even the sponsor, are not controlling in analyzing legislative history. [An individual legislator’s] statement must be considered with the Reports of both Houses and the statements of other Congressmen.”).
emerge from conference committee is much narrower than the version the Senate proposed. A super-majority in both houses of Congress approved the "would have been actionable" language. The final bill does not contain the Senate's proposed language: "no person may bring an action under this provision if the racketeering activity . . . involves fraud in the sale of securities." The substantive difference between the proposed and final versions of the amendment is the "actionable" language, which suggests a much narrower category of conduct than the broad, absolutely preclusive approach absorbs. Actionability, then, was an important trigger for Congress, and it should be for later interpreters, assuming that such legislative decisions are meaningful.

B. Conservation of Legal Matter: An Actionability Approach Reduces Error Costs

This section sets forth arguments for why a narrow reading of the PSLRA amendment to RICO in the form of an actionability analysis achieves the pro-social policy outcome of containing error costs. Most notably, this argument proceeds from the assumption that a narrow reading may capture a small but important class of cases at the margins that would be filtered out by an absolutely preclusive approach. In other words, there may be a small population of suits that would not be "actionable" after a thorough statutory analysis (and could therefore proceed), but might be summarily dismissed by an actionability analysis.

This contention is consistent with long-established canons of statutory interpretation. In general, the Supreme Court has advised that statutes be read narrowly when there are two possible interpretations of an ambiguous passage and one interpretation is harsher than the other (the so-called "rule of lenity"). Though strict adherence to this rule is usually confined to criminal statutes, the canon offers some guidance in the case of the PSLRA amendment to RICO. The existence and repeated invocation of the rule of lenity suggest a concern on the part of the judiciary about missing the kinds of marginal cases an actionability analysis captures.

Advocates for the absolutely preclusive reading of the amendment's scope may argue that a narrow reading, including an actionability analysis, will frustrate the preclusive purpose of

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107 See text accompanying note 31.
the PSLRA amendment and allow too many abusive or meritless lawsuits to proceed. This problem can be readily solved if judges police adherence to the Federal Rules of Civil Procedure (FRCP) in this area. FRCP Rule 9(b) requires that litigants pleading fraud do so with particularity. Plaintiffs can be required to plead the actionability element with specificity—that is, demonstrate conclusively that they had no other legal recourse than securities fraud under RICO—particularly if judges are as explicit about burden allocation for this element as was Judge Neff in *Ouwinga*.

The often unexamined use of an absolutely preclusive approach without reference to any legal authority or existing statutory framework seems to rebel against fundamental notions like *stare decisis* or even deductive legal reasoning. On the other hand, analyzing the case against known and established rules, as actionability judges do, is more consistent with these first principles. Most of the actionability tests applied by federal judges “borrow” from long-established securities law doctrine. This practice aligns these judges with entrenched Supreme Court canons of construction, most notably the *in pari materia* rule, adding jurisprudential legitimacy.

IV. CONCLUSION

To return to the ideological division I discussed at the beginning of this Comment, judicial approaches to the disputed issue outlined above can be grouped into categories representing broader views about securities litigation and civil RICO generally. Like Chief Justice Rehnquist and Representative Cox, those who find that securities litigation under RICO is abusive and duplicative argue for a broad reading of the PSLRA amendment. Like Representative Conyers and President Clinton, those who worry that a broad reading would deny legitimate claimants effective remedies argue for a narrower reading. For all the reasons stated above—the clear structure of the PSLRA amendment, the enactment history, and the policy objective of reducing error costs—I have argued that courts have been too hasty in dismissing this second set of arguments. Accordingly, the optimal

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109 “In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person’s mind may be alleged generally.” FRCP 9(b).

110 See text accompanying note 96.

pleading regime is one where courts perform a thorough actionability analysis to assure that the claimant is not unduly blocked from court.