ODOM v. MICROSOFT CORP.: THE NINTH CIRCUIT ABANDONS THE ENTERPRISE / RACKETEERING ACTIVITY DISTINCTION

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On May 4, 2007, the Ninth Circuit Court of Appeals issued its *en banc* opinion in *Odom v. Microsoft Corp.*, 486 F.3d 541 (9th Cir. 2007). One of the issues presented by the case was whether the plaintiff had adequately pled an association-in-fact enterprise that was distinct from the pattern of racketeering activity.

To be liable under RICO section 1962(c), a defendant must "conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity." Thus, under section 1962(c), "[t]he enterprise and its activity are two separate things. One is the enterprise. The other is its activity." *Id.* at 551.

The distinction between the enterprise and the pattern of racketeering activity can become murky, however, when RICO plaintiffs allege an association-in-fact enterprise, which is defined as "any union or group of individuals associated in fact although not a legal entity." 18 U.S.C. § 1961(4). The question then becomes whether a plaintiff states a RICO claim by alleging that a group of individuals engages in racketeering activity and is, therefore, an association-in-fact enterprise? In other words, does an enterprise exist whenever a group of people come together to engage in racketeering?

Many courts require that the members of an association-in-fact enterprise "do more" than simply engage in acts of racketeering. What "more" is required is unclear. To the extent an enterprise carries out legitimate objectives, in addition to allegedly criminal actions, the enterprise / racketeering activity distinction is not problematic. *Diamonds Plus, Inc. v. Kolber*, 960 F.2d 765, 770 n.5 (8th Cir. 1992) ("though it is not required, proof the enterprise conducts lawful activity unrelated to the pattern of racketeering activity will often serve to prove the enterprise is separate from the pattern of racketeering). With regard to wholly criminal association-in-fact enterprises, one court has stated:

> . . . [A] distinct structure might be demonstrated by proof that the group engaged in a diverse pattern of crimes or that it has an organizational pattern or system of authority beyond what was necessary to perpetrate the predicate crimes. The command system of a Mafia family is an example of this type of structure as is the hierarchy, planning, and division of profits within a prostitution ring.

United States v. Bledsoe, 674 F.2d 647, 665 (8th Cir.), *cert denied,* 459 U.S. 1040 (1982). "The focus of the inquiry is whether the enterprise encompasses

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more than what is necessary to commit the predicate RICO offense." *Diamonds Plus, Inc.*, 960 F.2d at 770. It is not enough that individual members of the enterprise carry on activities distinct from the pattern of racketeering; the group as a whole must have a common link other than the racketeering activity. *McDonough v. National Home Ins. Co.*, 108 F.3d 174, 177 (8th Cir. 1997).

I have often criticized the enterprise / racketeering activity distinction as an arbitrary tool used by the courts to dismiss RICO claims that comply with the technicalities of the RICO Act but do not describe "racketeering" in the traditional, Mafia-based scenario.

For example, in *Atlas Pile Driving Co. v. DiCon Financial Co.*, 886 F.2d 986 (8th Cir. 1989) the plaintiffs were subcontractors who claimed that two individual defendants and the companies they formed engaged in a scheme to defraud residential housing subcontractors. The subcontractors alleged that the seller of land, the lender, and the general contractor devised a scheme whereby the general contractor falsely promised payment for work completed on residential housing projects, the lender foreclosed its prior lien on the property, and the misled subcontractors were unable to collect from the general contractor or obtain relief against the value of the property. *Id.* at 987. The plaintiffs alleged an association-in-fact enterprise consisting of the seller, the lender, and the general contractor. After the jury returned a verdict in favor of the plaintiffs, the defendants appealed, arguing that the plaintiffs had not established an enterprise that was distinct from the pattern of racketeering, i.e., the only common link among the members of the enterprise was the alleged scheme to defraud the subcontractors. The Eighth Circuit disagreed and held that the association-in-fact enterprise was distinct from the pattern of racketeering:

> . . . the evidence . . . shows that the enterprise had an on-going structure and that its members were not engaged in sporadic criminal activity. Here, the enterprise, its participants and their employees sold real estate, loaned money to develop properties, performed subcontracting work, and built single-family residences. [Citations omitted.] . . . Thus, it has been demonstrated that the enterprise had "an organizational pattern or system of authority beyond what was necessary to perpetrate the predicate crimes.

Id. at 996.

The Eighth Circuit, however, reached the opposition conclusion in *McDonough*, which involved a very similar association-in-fact enterprise. In *McDonough*, the plaintiffs were homebuyers who alleged that the defendant builders, real estate agents, inspectors, insurers, and lenders concealed from the plaintiffs that their homes were built upon an unstable landfill. 108 F.3d at 176. The plaintiffs alleged an association-in-fact enterprise consisting of the defendants and that defendants had engaged in a pattern of fraudulent concealment through this

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enterprise. The Eighth Circuit affirmed the dismissal of the plaintiffs' RICO claim on the basis that the association-in-fact enterprise was not distinct from the pattern of racketeering:

> That each member of a group carries on activities distinct from the pattern of racketeering is insufficient; the group as a whole must have a common link other than the racketeering activity. . . . In the instant case, the plaintiffs' three complaints and two RICO statements fail to allege the existence of a structure distinct from the minimal association necessary to defraud the plaintiffs into buying the defective land and homes. In both RICO statements, in fact, the plaintiffs conceded that the only activities of the alleged enterprise were those of the racketeering scheme.

Id. at 177.

The conflicting results in *Atlas Pile Driving* and *McDonough* are difficult to reconcile under any objective standard. In *Atlas Pile Driving*, the enterprise's legitimate activities, *i.e.*, the group "sold real estate, loaned money to develop properties, performed subcontracting work, and built single-family residences," evidenced that the enterprise was distinction from the pattern of racketeering designed to defraud the subcontractors. Yet, in *McDonough*, the enterprise necessarily engaged in the same legitimate activities, i.e., the group "sold real estate, loaned money to develop properties, performed subcontracting work, and built single-family residences." Even if the only goal of the *McDonough* enterprise was to defraud the plaintiff home buyers, the enterprise engaged in legitimate activities – and like the enterprise in *Atlas Pile Driving* did more than simply engage in acts of racketeering – in furtherance of the scheme to defraud. The legitimate activities of the enterprise should have been sufficient to distinguish the enterprise from its fraudulent activities. The differing results in *Atlas Pile Driving* and *McDonough* highlight the arbitrary nature of the racketeering activity / enterprise distinction.

In *Wagh v. Metris Direct, Inc.*, 363 F.2d 821 (9th Cir. 2003), the Ninth Circuit also applied the racketeering activity / enterprise distinction to dismiss a plaintiff's claim. In *Wagh*, the plaintiff alleged that Metris, a credit protection company, had violated RICO by causing Citibank to bill Wagh's credit card $119.95 even though Wagh had never enrolled in the Metris program. *Id.* at 825. The Ninth Circuit dismissed Wagh's RICO claim on the basis of his failure to plead an enterprise distinct from the pattern of racketeering:

> Under this Circuit's interpretation of the enterprise element, "the predicate acts of racketeering activity, by themselves, do not satisfy the RICO enterprise element." [Citations omitted.] A RICO plaintiff must allege a structure for the making of decisions separate and apart from the alleged racketeering activities, because "the

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> existence of an enterprise at all times remains a separate element which must be proved." [Citations omitted.]
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> In this case, Wagh has not alleged a decision-making structure for the enterprise "beyond that which was inherent in the alleged acts of racketeering activity." [Citations omitted.] As the district court noted in its second order granting Metris Direct's motion to dismiss,
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> > The basis of [Wagh's] allegation is apparently that "a normal credit card transaction" between Defendants, Citibank, and [Wagh] is an action sufficient to satisfy the criminal enterprise requirement. Again, however, Plaintiff has failed to meet the enterprise requirements established by the Ninth Circuit in presenting this theory of enterprise. Plaintiff has not alleged that Defendants and Citibank have established a system of making decisions in furtherance of their alleged criminal activities, independent from their respective regular business practices. Nor has Plaintiff alleged that an independent system of distributing the proceeds of money obtained from persons like Wagh exists between the Defendants and Citibank.
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> [Citation omitted.] Wagh has therefore failed to allege the elements of a violation of § 1962(c) and the dismissal of this claim was correct.

In "*Wagh v. Metris Direct, Inc. (Nov. 7, 2003)*: The Ninth Circuit Wisely Dismisses Civil RICO Claims under Section 1962(a) and (b), but Affirms the 'Result-Oriented' Racketeering Activity / Enterprise Distinction Under Section 1962(c)", I wrote:

> Although widely accepted, the racketeering activity / enterprise distinction under section 1962(c) is not an intellectually honest standard. The distinction seems to be relied upon as a "judicial tool" that a court can use to get rid of a civil RICO claim that it doesn't like, i.e., a civil RICO claim predicated on weak or tenuous allegations of mail or wire fraud. To understand the intellectual dishonesty of the standard, one need only consider its application to the Mafia, the very enterprise that the RICO Act was designed to address. Is the Mafia distinct from the acts of racketeering that it engages in? Does the Mafia have activities that are distinct or independent from its criminal activities? If the Mafia owns legitimate businesses, the businesses are usually used to launder money and are not wholly distinct from the criminal acts. Does the Mafia have an independent system of distributing the proceeds of

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> its racketeering? In order be intellectually honest, the racketeering activity / enterprise distinction should apply in all RICO claims. It is hard to imagine that any court would, however, dismiss a RICO claim against a Mafia member because there was no distinction between the Mafia and the alleged acts of racketeering. In fact, in *United States v. Turkette*, 452 U.S. 576 (1981), the Supreme Court essentially rejected such an argument, holding that RICO applies to wholly illegitimate enterprises.

In May 2007, the Ninth Circuit issued its *en banc* opinion in *Odom.* The *Odom* complaint alleged that when customers bought computers at Best Buy, Best Buy would enroll the customers in a "free" six-month MSN trial membership; if the customer did not cancel the membership within six-months, the customers' credit cards would be charged an MSN membership fee. 486 F.3d at 543. The plaintiff alleged an association-in-fact enterprise consisting of Microsoft and Best Buy. The district court dismissed the plaintiffs' RICO claims on the basis that plaintiffs' alleged enterprise was not distinct from the pattern of racketeering.

The Ninth Circuit disagreed with the district court and abrogated the application of the racketeering activity / enterprise distinction in RICO cases under its jurisdiction. In doing so, the Ninth Circuit echoed my earlier criticism of the standard:

> To require that an associated-in-fact enterprise have a structure beyond that necessary to carry out its racketeering activities would be to require precisely what the Court in *Turkette* held that RICO does *not* require. Such a requirement would necessitate that the enterprise have a structure to serve both illegal racketeering activities as well as legitimate activities. . . . But the Court in *Turkette* held precisely the opposite. It held that a purely criminal enterprise can be an associated-in-fact enterprise within the meaning of RICO. [Citations omitted.]
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> . . . There must, of course, be an associated-in-fact enterprise, as required by the statute and as explained in *Turkette*. But there is no additional requirement that the enterprise have an "ascertainable structure."

Id. at 551-552.

The Ninth Circuit further held that a plaintiff need merely meet the three criteria of an association-in-fact enterprise set forth in *Turkette:* 1) the members of the enterprise must share a "common purpose, 2) the members must function as an "ongoing organization, formal or informal," and 3) the members must function as a "continuing unit." *Id.* at 552. The *Odom* plaintiffs' enterprise satisfied these three criteria. The common purpose of the enterprise was to increase the

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number of people using MSN by fraudulent means. *Id.* at 552. Microsoft and Best Buy functioned as an "ongoing organization" in that they had established mechanisms to transfer plaintiffs' personal information from Best Buy to Microsoft, enabling Microsoft to activate the plaintiff customers' MSN accounts without their knowledge or permission and to bill the customers for their MSN membership. *Id.* Microsoft and Best Buy's cross-marketing contract provided further evidence of an ongoing organization. *Id.* Finally, plaintiffs alleged that Best Buy and Microsoft functioned as a "continuing unit" in that the alleged scheme to defraud covered a two year period. *Id.* at 553.

The Ninth Circuit's holding in *Odom* is well-reasoned. The enterprise element of a RICO claim should focus on the nature of the group's membership and organization, not on the group's activity – after all, defendants are liable for RICO violations – not enterprises. In many cases, a defendant uses an enterprise to perpetrate acts of racketeering, but an enterprise may also be the "prize," "instrument," or "victim." *National Organization for Women, Inc. v. Scheidler*, 510 U.S. 249, 259 n.5 (1994). Thus, the members of an association-in-fact enterprise may engage only in racketeering activity or may engage in no racketeering activity whatsoever.

Turkette's criteria that: 1) the members of the enterprise share a "common purpose, 2) the members function as an "ongoing organization, formal or informal," and 3) the members function as a "continuing unit" sufficiently ensure that an association-in-fact enterprise exists in reality, not merely in the plaintiff lawyer's mind. The three criteria also prevent plaintiffs from engaging in the circular reasoning that an association-in-fact enterprise exists whenever individuals join together to engage in racketeering activity. Such a group may share are common purpose, but will not likely have an ongoing organizational structure and/or function as a continuing unit.

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