Denver Law Review

Volume 70
Issue 2 *Colloquy - Racism in the Wake of the Los Angeles Riots*

Article 16

January 2021

Holmes v. Securities Investor Protection Corp.: A Disappointing Attempt to Limit RICO Actions for Securities Fraud

Jonathan Coe

HOLMES V. SECURITIES INVESTOR PROTECTION CORP.: A DISAPPOINTING ATTEMPT TO LIMIT RICO ACTIONS FOR SECURITIES FRAUD

I. INTRODUCTION

The Racketeer Influenced and Corrupt Organizations Act (RICO)[1] has emerged as a prominent force in the legal community.[2] *Holmes v. Securities Investor Protection Corp.*[3] was supposed to be the turning point in RICO litigation—the solution for the questions concerning the scope of RICO in civil litigation, especially securities fraud.[4] Many lawyers hoped that the United States Supreme Court would use the case to resolve the much-disputed issue of whether a plaintiff had to be a purchaser or seller of securities in order to maintain a RICO action for securities fraud. In a surprising decision the Court avoided the purchaser-seller question, and instead held that the RICO violation must constitute a direct, or proximate, cause of the plaintiff's injuries.[5]

Holmes's immediate impact on the RICO statute and securities law appears equivocal. This Comment discusses the ambiguities of the RICO/securities fraud issue, speculates how the lower courts will interpret *Holmes* and draws the conclusion that courts should apply the purchaser-seller standing requirements of the federal securities laws when resolving a case involving RICO and securities fraud.

II. BACKGROUND

A. *RICO*

Congress initially enacted Title IX of the Organized Crime Control Act of 1970,[6] better known as the Racketeer Influenced and Corrupt Organizations Act (RICO), to assist law enforcement in fighting organized crime,[7] but the legislature also included explicit language allowing

1. 18 U.S.C. §§ 1961-1968 (1988 & Supp. II 1990).

2. Susan Getzendanner, *Judicial "Pruning" of "Garden Variety Fraud" Civil RICO Cases Does Not Work: It's Time for Congress to Act*, 43 VAND. L. REV. 673, 674 (1990).

3. 112 S. Ct. 1311 (1992).

4. *See* David Tobenkin, *Supreme Court Ruling May Rewrite Securities Law*, LOS ANGELES BUS. J., Nov. 11, 1991, § 1, at 5; *High Court To Weigh Limits Of Securities-Linked RICO Claims*, WALL ST. LETTER, Nov. 11, 1991, at 2 (predicting that the "fate of applicability of the securities seller/purchaser test under RICO . . . will certainly be determined").

5. *Holmes*, 112 S. Ct. at 1322.

6. Pub. L. No. 91-452, 84 Stat. 922 (1970) (codified at 18 U.S.C. §§ 1961-1968 (1988 & Supp. II 1990)).

7. In the introduction to the Act, the legislature stated:

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

Id. See also Michael N. Glanz, Note, *RICO and Securities Fraud: A Workable Limitation*, 83 COLUM. L. REV. 1513 (1983).

for civil actions by persons injured "by reason of" a RICO violation.[8] To constitute a violation, a person involved in an "enterprise"[9] must participate in a "pattern of racketeering activity."[10] RICO specifies a number of predicate offenses that constitute racketeering activity, including "fraud in the sale of securities."[11] Civil remedies for a RICO violation include treble damages and reasonable attorney's fees.[12]

Since the enactment of RICO, commentators have debated the scope of the predicate offense concerning securities fraud.[13] Legislative history provides inadequate support for a plausible interpretation.[14] Congress did not include securities fraud as a predicate offense in the early drafts of RICO, but added it later before enacting the statute.[15] The current debate centers around whether Congress intended to include the purchaser-seller standing requirement of Rule 10b-5,[16] or any of the guidelines of the federal laws, in adding securities fraud to RICO.[17]

B. *Securities Fraud*

Section 10(b) of the Securities Exchange Act of 1934[18] and Rule 10b-5[19] are the statutory means by which the Securities and Exchange

8. 18 U.S.C. § 1964(c).

9. *Id.* § 1961(4). The term "enterprise" encompasses "any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity." *Id.*

10. *Id.* § 1961(5). The statute describes a "pattern of racketeering activity" as "at least two acts of racketeering activity, one of which occurred after the effective date of this chapter and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity." *Id.*

11. *Id.* § 1961(1)(D).

12. *Id.* § 1964(c).

13. *See, e.g.*, Arthur F. Mathews, *Shifting the Burden of Losses in the Securities Markets: The Role of Civil RICO in Securities Litigation*, 65 NOTRE DAME L. REV. 896, 944-45 (1990); Glanz, *supra* note 7, at 1516-17.

14. Thomas W. Alvey, III, Note, *Puncturing The RICO Balloon: The Judicial Imposition Of The 10b-5 Purchaser-Seller Requirement*, 41 WASH. U. J. URB. & CONTEMP. L. 193, 200 (1992). *See also* Andrew P. Bridges, *Private RICO Litigation Based Upon "Fraud In The Sale Of Securities"*, 18 GA. L. REV. 43, 58 (1983) (recognizing four potential interpretations of "fraud in the sale of securities").

15. Bridges, *supra* note 14, at 58-59.

16. *See* Harvey L. Pitt et al., *Once Again, the Court Fails to Rein in RICO*, LEGAL TIMES, Apr. 27, 1992, at 31 (stating that the "genesis" of the debate is the purchaser-seller requirement).

17. Mathews, *supra* note 13, at 944.

18. Securities Exchange Act of 1934, 15 U.S.C. § 78(b) (1988 & Supp. II 1990).

19. 17 C.F.R. § 240.10b-5 (1991). Rule 10b-5 states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Recently, the Supreme Court limited actions filed under Rule 10b-5 by adopting "the 'one year from discovery, three years from the event' statute of limitations, derived from other sections of the 1934 Act." Joseph Cachey, Lampf v. Gilbertson: *Rule 10b-5's Time*

Commission (SEC) enforces federal laws governing securities fraud. The important case history of the purchaser-seller requirement began with *Birnbaum v. Newport Steel Corp.*[20] In *Birnbaum*, a group of stockholders sued Newport Steel, its president and the directors of the corporation for alleged securities fraud.[21] The defendants shunned a potentially profitable merger for the plaintiff-stockholders and instead sold their own shares to a third company at a substantial premium to the current market price.[22] In affirming the lower court's dismissal for failure to state a cause of action, the United States Court of Appeals for the Second Circuit decided that Congress constructed Rule 10b-5 specifically for fraud involving the purchase or sale of securities, not for management's fraudulent supervision of corporate matters.[23] The court held that a person who fails to qualify as a purchaser or a seller of securities may not sustain a securities fraud claim based on Rule 10b-5.[24]

Twenty-three years later, the Supreme Court upheld the *Birnbaum* rule in *Blue Chip Stamps v. Manor Drug Stores*,[25] a significant decision for securities fraud. The case involved an offering of securities by a newly formed corporation, Blue Chip Stamps, to customers of the old Blue Chip Stamp Co. The plaintiffs, customers who did not purchase stock, claimed that the prospectus issued prior to the offering discouraged them from buying shares so that the company could reoffer the stock to the public at a higher price.[26] The plaintiffs brought a class action suit for profits lost in not buying the stock, the price of which increased subsequent to the public offering.[27] The Supreme Court applied the *Birnbaum* rule and held that only purchasers and sellers of securities have standing to sue for a violation of Rule 10b-5.[28] The Court grounded its opinion on legislative history, precedential developments since *Birnbaum* and several public policy considerations.[29] The policy factors looked at by the Court included the consequences that lawsuits would have on the defendant's daily business activities, the ability of plaintiffs to use groundless claims to enhance the settlement value of their case and fact issues that hinged on oral testimony, further reducing the chances of settlement.[30] The Court expressed deep concern about the potential for "vexatious litigation"[31] and perceived that the benefit of preventing frivolous suits outweighed the undesirable effects of excluding those

Has Come, 69 DENV. U. L. REV. 135 (analyzing the split in the circuits regarding the proper statute of limitations and the Court's resolution of the earlier uncertainties).

20. 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952).

21. *Id.* at 462.

22. *Id.*

23. *Id.* at 464.

24. *Id.* at 463. This holding became known as the *Birnbaum* rule. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730-31 (1975).

25. 421 U.S. 723 (1975).

26. *Id.* at 726.

27. *Id.* at 727.

28. *Id.* at 754-55.

29. Glen E. Mercer, Note, *Violation of Rule 10b-5 As a Predicate Act Under Civil RICO*, 51 LA. L. REV. 1111, 1112-14 (1991).

30. *Id.* at 1114.

31. *Blue Chip Stamps*, 421 U.S. at 739-45.

persons actually damaged by a Rule 10b-5 violation.[32]

The number of securities fraud cases involving RICO soared in the mid-1980's[33] as frustrated investors who failed to meet the purchaser-seller requirement in Rule 10b-5 began using RICO as a tool to avoid the standing limitation. The broad language used in the statute[34] and the liberal interpretation that the courts exercised[35] contributed significantly to the move to RICO. As plaintiffs began combining RICO with securities fraud actions, the judicial system experienced difficulties sorting out the differences in the securities laws and RICO. The privilege to bring suit under Rule 10b-5 arises from an implied cause of action developed by the courts.[36] *Birnbaum* further limited the implied right to purchasers and sellers of securities.[37] Yet, the provisions of the above securities laws did not appear in the language of RICO,[38] although the SEC had initiated federal laws governing securities fraud long before Congress ever considered RICO.[39] Confusion determining the standing requirement needed to bring a RICO claim in a securities action results from this omission.

C. *Standing*

A plaintiff suing under RICO has standing to sue only if an injury has occurred as a result of conduct prohibited by the statute.[40] The confusion over whether the standing requirements of the securities laws apply to a RICO action based on securities fraud resulted in divided courts and ambiguous law.[41] In *International Data Bank, Ltd. v. Zepkin*,[42] a corporation sued the two individuals who initially started the business, claiming that the two falsified information in a prospectus and caused the corporation to suffer losses.[43] The Fourth Circuit asserted that the

32. *Id.* at 743. Much of the disagreement concerning the purchaser-seller issue results from excluded plaintiffs, such as an owner of a security who does not sell because of the fraudulent behavior. Thus, even if a distressed investor exists, he is unable to sue because of the purchaser-seller limitation. Linda Greenhouse, *Court Limits Agency on Stock-Fraud Suits*, N.Y. TIMES, Mar. 25, 1992, at C2.

33. Alvey, *supra* note 14, at 194-95.

34. 18 U.S.C. §§ 1961-68 (1988 & Supp. II 1990) (RICO "shall be liberally construed to effectuate its remedial purposes.").

35. *See* United States v. Turkette, 452 U.S. 576, 587 (1981) (asserting that the language of RICO should not be limited); Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 497 (1985) ("RICO is to be read broadly.").

36. Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946) (investors convinced to sell stock for much less than actual value sustained a cause of action under the securities laws because "the mere omission of an express provision for civil liability is not sufficient to negative what the general law implies.").

37. Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952).

38. Alvey, *supra* note 14, at 204.

39. Congress enacted the securities laws in 1933 and 1934 and RICO in 1970.

40. Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 496 (1985).

41. Mathews, *supra* note 13, at 947; Mercer, *supra* note 29, at 1121 (asserting that it is "equally plausible that Congress meant to retain the *Birnbaum* rule [in RICO] as it is that Congress meant to overturn it").

42. 812 F.2d 149 (4th Cir. 1987).

43. *Id.* at 150.

purchaser-seller standing requirement applies to RICO claims based on securities fraud.[44] The court held that because the corporation and its officers and directors were not purchasers or sellers of stock, all lacked standing to sue.[45] Because Congress did not explicitly state any limitation, the court followed the precedent established in securities fraud actions,[46] the *Birnbaum* rule.[47]

The Eleventh Circuit's ruling in *Warner v. Alexander Grant & Co.*[48] lies in direct contrast to the holding in *International Data Bank*. Warner was a customer of ESM Government Securities and a principal in two banks that were also ESM customers. He sued the company's auditors, claiming they filed false and misleading reports regarding the financial condition of ESM.[49] Although Warner could not maintain an action under the federal securities laws, the court stated that he need not meet the purchaser-seller requirement to sustain a RICO claim based on securities fraud.[50] The court simply stated that a plaintiff "need only allege injuries personally sustained as a result of conduct violative of the federal RICO statute."[51] The Ninth Circuit added to the disarray among the circuits by omitting the purchaser-seller limitation in *Securities Investor Protection Corp. v. Vigman*,[52] the precursor to the instant case.[53]

III. INSTANT CASE

A. *Facts*

Congress established the Securities Investor Protection Corporation (SIPC), a nonprofit private corporation,[54] following the Securities Investor Protection Act of 1970.[55] The SIPC is comprised of broker-dealers required to become members upon registration with the Securities and Exchange Commission.[56] In establishing the SIPC, Congress provided the agency, inter alia, with the authority to seek the liquidation of a broker-dealer's business to meet customers' obligations when the level of its assets indicated a failure or a threat of failure.[57]

In 1981, the SIPC began liquidation proceedings against two broker-dealers. The SIPC claimed that the broker-dealers had insufficient assets to meet the obligations of their customers and that it disbursed over $13 million to cover the shortage.[58] Subsequently, the SIPC filed

44. *Id.* at 151.
45. *Id.* at 151-53.
46. *Id.* at 152.
47. *See supra* text accompanying notes 20-24.
48. 828 F.2d 1528 (11th Cir. 1987).
49. *Id.* at 1529.
50. *Id.* at 1530.
51. *Id.*
52. 908 F.2d 1461 (9th Cir. 1990).
53. *Id.* at 1467.
54. 15 U.S.C. § 78ccc(a)(1) (1988).
55. *Id.* §§ 78aaa-78lll.
56. *Id.* § 78ccc(a)(2)(A).
57. *Id.* § 78eee.
58. Holmes v. Securities Investor Protection Corp., 112 S. Ct. 1311, 1315 (1992).

suit against Holmes and 75 other defendants, claiming that they employed the broker-dealers in a scheme to inflate the price of the shares of several companies and create the misconception that a stable market existed for the stocks.[59] The discovery of the scheme caused a dramatic decline in the price of the shares of these companies, and the stock owned in the proprietary accounts of the two broker-dealers sustained huge losses.[60] The SIPC claimed that the defendants violated Section 10b of the Securities Exchange Act of 1934, Rule 10b-5, the mail and wire fraud statutes[61] and the federal RICO laws.[62]

B. *Lower Courts*

The SIPC filed the original lawsuit in 1983 in district court in California.[63] The first two appellate court decisions involving these parties concerned different procedural matters.[64] In the third decision, the district court held the SIPC did not have proper standing to bring a RICO claim and defendant's actions were not the proximate cause of the losses sustained, so the SIPC appealed.[65] The United States Court of Appeals for the Ninth Circuit reversed and remanded on the ground that the purchaser-seller limitation in Rule 10b-5 does not apply to RICO claims based on securities fraud.[66] The court of appeals decided that the lower court erred in granting summary judgment on the proximate cause issue because a fact question remained as to whether a causal connection existed between the defendant's actions and the broker-dealers' losses.[67]

C. *Majority Opinion*

The Supreme Court granted certiorari on only one issue: whether the SIPC has the right to bring a securities fraud action under RICO.[68] In an opinion by Justice Souter, the Court reversed and remanded the decision of the court of appeals. The Court held the SIPC failed to state a claim because the alleged actions by the defendant were not a proximate cause of the SIPC's losses.[69] The majority refused to address the question of whether RICO required a party to be a purchaser or seller in order to bring a claim based on securities fraud.[70] Instead, it found

59. *Id.*
60. *Id.*
61. 18 U.S.C. §§ 1341, 1343 (1988 & Supp. II 1990).
62. *Holmes*, 112 S. Ct. at 1315.
63. Securities Investor Protection Corp. v. Vigman, 587 F. Supp. 1358 (C.D. Cal. 1984).
64. Securities Investor Protection Corp. v. Vigman, 803 F.2d 1513 (9th Cir. 1986) (reversing lower court decision to dismiss SIPC's 10b-5 claim); Securities Investor Protection Corp. v. Vigman, 764 F.2d 1309 (9th Cir. 1985) (reversing the district court's decision to dismiss four defendants for lack of personal jurisdiction and improper venue).
65. Securities Investor Protection Corp. v. Vigman, 908 F.2d 1461, 1465 (9th Cir. 1990).
66. *Id.* at 1467.
67. *Id.* at 1468-69.
68. Holmes v. Securities Investor Protection Corp., 112 S. Ct. 1311, 1316 (1992).
69. *Id.* at 1322.
70. *Id.*

a discussion of the problem unnecessary and not relevant to the decision.[71]

In determining that RICO requires proximate cause to sustain an action, the majority focused on specific language in the RICO statute: "[a]ny person injured in his business or property by reason of a violation"[72] may bring an action. Relying on statutory history,[73] Souter concluded that Congress fashioned § 1964(c) of RICO after Section 4 of the Clayton Act,[74] which itself imitated language from Section 7 of the Sherman Act.[75] Souter stated that courts repeatedly interpreted the Sherman Act as requiring proximate causation and the Supreme Court previously held that the Clayton Act required proof of proximate cause.[76] The Court therefore found by analogy that RICO also requires proximate cause.[77]

Souter relied on several policy initiatives to justify his use of proximate cause. First, the further removed an injury is from the violation, the harder to trace particular damages back to the infraction.[78] Second, to avoid multiple recoveries, courts would be forced to develop intricate rules for the apportionment of damages among differently injured plaintiffs.[79] Third, plaintiffs injured directly will bring private lawsuits and avoid those problems faced by remotely injured parties, thus reducing the societal demand for deterrence of the violations.[80]

The Court refused to address the purchaser-seller issue despite urging by appellant Holmes and dissension among the lower courts.[81] Souter found the instant case untimely for a settlement of the issue[82] because the lower courts could have used proximate cause to decide the conflicting cases.[83] Furthermore, none of the cases involved parties who failed to qualify as a purchaser or seller because of reliance on a broker's advice, as occurred in *Blue Chip Stamps*.[84]

D. *Justice O'Connor's Concurring Opinion*

Justice O'Connor, joined by Justices White and Stevens, addressed

---

71. *Id.*
72. *Id.* at 1316 (citing 18 U.S.C § 1964(c) (1988 & Supp. II 1990)).
73. *Holmes*, 112 S. Ct. at 1317 (citing Agency Holding Corp. v. Malley-Duff & Assoc., Inc., 483 U.S. 143 (1987); Shearson/American Express Inc. v. McMahon, 482 U.S. 220 (1987); Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479 (1985)).
74. Clayton Act, 15 U.S.C. § 18 (1988 & Supp. II 1990).
75. Sherman Act, 15 U.S.C. § 1 (1988 & Supp. II 1990).
76. For a discussion of the enactment of § 4 of the Clayton Act based on language from § 7 of the Sherman Act, see Associated Gen. Contractors of Cal., Inc. v. California State Council of Carpenters, 459 U.S. 519 (1983).
77. *Holmes*, 112 S. Ct. at 1317-18.
78. *Id.* at 1318.
79. *Id.*
80. *Id.*
81. *See supra* text accompanying notes 40-52.
82. *Holmes*, 112 S. Ct. at 1322. "[O]ur discussion of the issue would be unnecessary to the resolution of this case. Nor do we think that leaving this question unanswered will deprive the courts of much-needed guidance." *Id.*
83. *Id.*
84. *Id.*

the question on which the Court granted certiorari. The Justices concluded that a plaintiff can sustain a RICO action based on securities fraud without meeting the purchaser-seller requirement.[85] O'Connor argued for a strict reading of the statement in the RICO statute authorizing "any person" to sue and determined that courts should not impose the purchaser-seller requirement of Rule 10b-5 in a RICO action.[86] In her opinion, Congress chose to institute a private right of action for plaintiffs without requiring a purchase or sale of securities and the Court should not impede the intentions of Congress.[87]

As to the majority's use of causation to decide the case, O'Connor seemed satisfied with the assertion that proximate cause emerged as an element of the question before the Court.[88] In her opinion, however, the requirement of a proximate connection between the injury or harm and the defendant's conduct should not prevent one who lacks purchaser-seller standing from bringing a civil RICO action.[89]

E. *Justice Scalia's Concurring Opinion*

Justice Scalia agreed with Justice O'Connor that the purchaser-seller requirement should not apply to civil RICO actions based on securities fraud, but he surmised that "[t]he ultimate question here is statutory standing . . . ."[90] Courts must first determine if the "nexus" between the plaintiff's harm and the defendant's conduct supports a RICO cause of action.[91] The question of proximate cause only factors into the standing equation because, without express directions otherwise from a legislature, courts always consider proximate cause in deciding questions of recovery.[92]

In Justice Scalia's opinion, the purchaser-seller requirement falls under another element of statutory standing, the "zone-of-interest" test.[93] This test ascertains if the plaintiff falls within the category of persons served by the particular rule.[94] Courts should apply this test, along with the proximate cause test, in determining whether a plaintiff has standing to sue.[95] Similar to Justice O'Connor, Justice Scalia theorized that the Court should not imply any limitation into RICO because Congress created the statute and elected not to limit the rights of civil RICO plaintiffs.[96]

---

85. *Holmes*, 112 S. Ct. at 1322 (O'Connor, J., concurring).

86. *Id.* at 1323. "Insofar as 'any' encompasses 'all', the words 'any person' cannot reasonably be read to mean only purchasers and sellers of securities." *Id.* (citation ommitted).

87. *Id.* at 1327.

88. *Id.* at 1322.

89. *Id.* at 1324.

90. *Holmes*, 112 S. Ct. at 1327 (Scalia, J., concurring).

91. *Id.*

92. *Id.* "Life is too short to pursue every human act to its most remote consequences." *Id.* (Scalia, J., concurring).

93. *Id.* at 1328.

94. *Id.*

95. *Id.*

96. *Id.* at 1329.

IV. ANALYSIS

Aside from the fact that the Court sidestepped the most important issue—standing—it made an appropriate decision in denying the SIPC relief because of a lack of causation. As Justice Souter noted, courts generally utilize proximate cause "to limit a person's responsibility for the consequences of that person's own acts."[97] Assuming Holmes actually committed the alleged acts, the broker-dealers' collapse could be attributed to many other possible factors, making it impossible to impute full responsibility to Holmes.[98] Other possible causes included the failure of the broker-dealers to diversify assets, poor supervision of the business and weak market conditions.[99]

By requiring that a proximate relationship exist between a defendant's violation and the plaintiff's injuries, the Court tightened a fixture of RICO.[100] For the first time, the Court restricted the breadth of RICO,[101] despite contrary language in both the statute[102] and prior Supreme Court cases.[103] However, because the Court dodged the question upon which it granted certiorari, two approaches to interpreting *Holmes* emerged. A lower court may adopt either approach, depending on its Circuit's rule on the purchaser-seller issue prior to the decision.

A. *The Purchaser-Seller Limitation Does Not Apply To RICO Actions Based On Securities Fraud*

Courts may interpret the concurring opinions in *Holmes* as the future of the law,[104] given the 5-4 split on the purchaser-seller issue.[105] Courts could choose not to apply the purchaser-seller requirement and instead follow Souter's lead by using proximate cause as the sole basis for deciding RICO actions. This interpretation supports the argument that, while courts have implied a cause of action under Rule 10b-5,[106]

97. *Holmes*, 112 S. Ct. at 1318.

98. *Id.* at 1320.

99. *Id.*

100. *See* Pitt, *supra* note 16, at 31 (stating that the Court "pronounced a black-letter legal requirement that had, prior to the grant of certiorari, already been thought to have been well-established in RICO jurisprudence.").

101. Edward Brodsky, *RICO - Limitation And Expansion*, N.Y. L. J., Apr. 8, 1992, at 3.

102. *See* 18 U.S.C. § 1961-68 (1988 & Supp. II 1990) (RICO "shall be liberally construed to effectuate its remedial purposes.").

103. *See* United States v. Turkette, 452 U.S. 576, 587 (1981) (asserting that the language of RICO should not be limited); Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 497 (1985) ("RICO is to be read broadly.").

104. Brodsky, *supra* note 101, at 3. *See also* Greenhouse, *supra*, note 32, at C2 ("With four Justices already on record, it is likely the Court will resolve the issue in favor of investors.").

105. Andrew Leigh, *Supreme Court Ruling Has Weakened RICO—Maybe*, INVESTOR'S BUS. DAILY, Mar. 27, 1992, at 8.

106. The first case to find an implied private right of action under Rule 10b-5 was Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946) (Investors convinced to sell stock for much less than actual value sustained a cause of action under the securities laws because "the mere omission of an express provision for civil liability is not sufficient to negative what the general law implies."). The Supreme Court later endorsed the holding in *Kardom*. *See* Superintendent of Insurance of N.Y. v. Bankers Life & Cas. Co., 404

Congress expressly provided for a private cause of action under RICO and courts are compelled to abide by the legislature's explicit directions.[107] Thus, the onus stays with Congress, and not the courts, to impose a purchaser-seller limitation for RICO actions,[108] a situation favored by both O'Connor[109] and Scalia.[110]

Based on their earlier rulings favoring the liberal approach to RICO,[111] the Ninth and Eleventh Circuits will likely favor the concurrences' approach to the purchaser-seller issue. Both courts relied heavily on the textual argument that RICO, on its face, does not contain any standing requirement as provided for by Rule 10b-5.[112] Thus, until Congress explicitly adds a standing clause specifically for securities fraud actions, these courts are apt to hold on to their prior convictions until expressly directed otherwise.

Such an interpretation implies substantial consequences, opening the door to a multitude of plaintiffs kept out of the courts by the purchaser-seller limitation.[113] Permitting indirectly injured plaintiffs to sue would create "massive and complex damages litigation [which] not only burdens the courts, but also undermines the effectiveness of treble-damages suits."[114] Disastrous effects on the securities industry could materialize, as persons and businesses involved in proxy matters and other nontrading activities suddenly become subject to tremendous liability.[115] For instance, a person who refrained from buying stock due to fraudulent negative information currently does not have a claim under the securities laws for failure to meet the standing requirement.[116] However, under the broad interpretation of RICO, a multitude of suits

---

U.S. 6, 13 (1971); Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 150-54 (1972).

107. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 748 (1975). The Court stated:

> [I]f Congress had legislated the elements of a private cause of action for damages, the duty of the Judicial Branch would be to administer the law which Congress enacted; the Judiciary may not circumscribe a right which Congress has conferred because of any disagreement it might have with Congress about the wisdom of creating so expansive a liability.

Id.

108. Pitt, *supra* note 16, at 31.

109. Holmes v. Securities Investor Protection Corp., 112 S. Ct. 1311, 1322 (1992) (O'Connor, J., concurring).

110. *Id.* at 1327 (Scalia, J., concurring).

111. Securities Investor Protection Corp. v. Vigman, 908 F.2d 1461 (9th Cir. 1990); Warner v. Alexander Grant & Co., 828 F.2d 1528 (11th Cir. 1987).

112. *Vigman*, 908 F.2d at 1466; *Warner*, 828 F.2d at 1530.

113. Tobenkin, *supra* note 4, at 5 (quoting Jack Samet, Holmes' attorney) ("The whole idea that a person must be a purchaser of a stock to sue would be moot.").

114. Associated General Contractors of Ca., Inc. v. California State Council of Carpenters, 459 U.S. 519, 545 (1983). Apportionment raises the overall costs of recovery by creating complex issues in determining each plaintiff's damages. In addition, dividing the damages among a larger number of plaintiffs diminishes the benefits to each plaintiff, possibly reducing the incentive to sue. Illinois Brick Co. v. Illinois, 431 U.S. 720, 745 (1977).

115. Geoffrey A. Campbell, *Justices Say Investor Protection Agency Can't Win Triple Damages Under RICO*, THE BOND BUYER, Mar. 25, 1992, at 5.

116. *Id.*

would appear featuring plaintiffs who claim they would have bought securities but abstained.[117] In addition, from a public policy standpoint, this approach appears "somewhat out of kilter with the current mood in Washington,"[118] which favors legal reform designed to reduce frivolous litigation.[119]

The courts' endorsement of this approach should come as no surprise to persons who followed the development of the RICO statute. Beginning in the early 1980's, people speculated that RICO would eventually work in favor of the securities fraud plaintiff.[120] Those favoring this view of *Holmes* would argue Congress could easily see RICO has emerged as a well-used tool in securities fraud actions and would have made changes in the law if necessary.[121] Therefore, claim the advocates of RICO, Congress inherently favors the liberal approach and the courts should not attempt to restrict RICO in favor of a narrow approach.[122]

B. *Proximate Cause Is Required In Addition To The Purchaser-Seller Limitation*

The lower courts may interpret the Court's decision to mean that a person who was not a purchaser or seller of securities cannot fulfill the proximate cause requirement.[123] Thus, until Congress explicitly states otherwise, the standing requirements firmly established for securities fraud actions under Section 10b of the Securities Exchange Act of 1934 and Rule 10b-5 continue to apply to RICO cases as well. Even though the majority did not specifically address the purchaser-seller issue, they "strongly hinted their commitment" to the rule,[124] asserting that problems with allowing indirectly injured plaintiffs to bring causes of action would burden the judicial system.[125] The Fourth Circuit will probably favor this approach, based on its 1987 opinion in *International Data Bank v. Zepkin*,[126] in which it interpreted Congress's actions (or lack thereof) relating to the purchaser-seller issue to mean the approval of

117. *Id.*

118. Pitt, *supra* note 16, at 31.

119. *Id.* The authors added, "This approach eschews uniformity and predictability under the law and runs counter to the growing consensus of the American public and its leaders that efforts should be made to control litigation, not to encourage the filing of even more suits." *Id.* at 33.

120. *See* Bridges, *supra* note 14, at 45 ("Private RICO may be for the eighties what rule 10b-5 was for the seventies."); Jeffrey G. MacIntosh, *Racketeer Influenced And Corrupt Organizations Act: Powerful New Tool Of The Defrauded Securities Plaintiff*, 31 KAN. L. REV. 7, 12 (1982) ("there is some support that RICO may relax at least one of the substantive limitations to an action under rule 10b-5—that the plaintiff must be either a purchaser or seller of securities.").

121. Brodsky, *supra* note 101, at 3.

122. In her concurring opinion, Justice O'Connor claimed that Congress expressly created the right for nonpurchasers and nonsellers to sue. Holmes v. Securities Investor Protection Corp., 112 S. Ct. 1311, 1327 (1992) (O'Connor, J., concurring) (citing United States v. Turkette, 452 U.S. 576, 587 (1981)).

123. Leigh, *supra* note 105, at 8 (referring to comments by Jack Samet, attorney for Holmes).

124. Campbell, *supra* note 115, at 5.

125. *Holmes* 112 S. Ct. at 1321 (1992).

126. 812 F.2d 149 (4th Cir. 1987).

the retention of Rule 10b-5's requirements.[127] The court stated that Congress "did not write the RICO statute in a vacuum."[128] By not taking explicit action, the court found that the legislature indicated a willingness to retain the requirements of the federal securities laws in RICO.[129]

This interpretation of *Holmes* agrees with the legal community's view of RICO and securities fraud[130] and constitutes the most sensible approach to a confusing situation for several reasons. First, an adoption of this narrow ruling by the lower courts would certainly reduce the fears of "vexatious litigation" that cause so much anxiety.[131] A narrow interpretation of the statute prevents securities plaintiffs from alleging non-securities fraud RICO offenses to secure a place in the courtroom. Second, placing limits on which persons can bring a RICO securities fraud action would help define the securities industry's potential liability[132] and redirect conventional securities fraud actions away from RICO to the appropriate controlling securities laws. In fact, a movement exists to eliminate securities fraud completely as a cause of action under RICO.[133] Finally, Congress designed RICO as "an aggressive initiative to supplement old remedies and develop new methods for fighting crime,"[134] not as an unrestricted panacea for plaintiffs and a means for skirting federal securities laws.

The jury is still out in terms of how this case will influence the legal community.[135] No clear answer exists as to which parties this decision will affect the most.[136] On one hand, the Court narrowed RICO by firmly establishing proximate cause as a requirement, while on the other hand it conceivably broadened the rule by not enforcing the purchaser-seller limitation for securities fraud actions.[137] If future decisions eliminate the purchaser-seller requirement as a result of *Holmes*, the net effect

127. *Id.* at 152.

128. *Id.*

129. *Id.*

130. *See, e.g.*, Edward F. Brodsky, *RICO And The Securities Laws*, N.Y. L. J., June 12, 1991, at 7 (purchaser-seller requirement should not be eliminated); Pitt, *supra* note 16, at 33 (controlling litigation is the consensus in America).

131. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 739-45 (1975).

132. Campbell, *supra* note 115, at 5.

133. Getzendanner, *supra* note 2, at 684 (arguing that "there is simply no general need to encourage litigation for securities fraud."). The Securities and Exchange Commission proposed that Congress revise RICO to eliminate lawsuits based on violations of securities fraud. *See* Pitt, *supra* note 16, at 31.

134. Sedima, S.P.R.L. v. Imrex, Co., 473 U.S. 479, 498 (1985). However, the dissent argues that RICO essentially eradicated the precedent that developed over time. Justice Marshall claimed that the securities law precedent "is now an endangered species because plaintiffs can avoid the limitations of the securities laws merely by alleging violations of other predicate acts." *Id.* at 505 (Marshall, J., dissenting).

135. Jed S. Rakoff, *The Supreme Court's Scolding Of RICO*, N.Y. L. J., Apr. 2, 1992, at 29 (explaining that the decision will simply "muddy the waters" and create uncertainty in the interpretation of proximate cause).

136. Leigh, *supra* note 105, at 8 (claiming that interpretations of the ruling depend on one's allegiance).

137. Pitt, *supra* note 16, at 33.

will be a limitation on plaintiffs' chances of recovery but an increase in the number of persons entitled to bring a cause of action.

C. *Standing Under the Purchaser-Seller Limitation*

When the Supreme Court announced that it granted certiorari in *Holmes*, the financial and legal communities believed the case would finally resolve the RICO issue.[138] The potential implications arising out of the decision created substantial interest among followers of securities law. Prior to the Court's decision, one commentator surmised that an affirmance of the court of appeals would set an alarming precedent for averting the standing limitations needed to bring RICO actions based on other violations,[139] resulting in an increase in the number of frivolous lawsuits filed by plaintiffs far removed from the actual transaction.[140] Proponents of the statute looked forward to a broad interpretation enabling those with no claims under the securities laws to access RICO.[141]

Instead, neither party came away satisfied with the outcome, for the Court dodged the question that people most wanted answered. Even Souter himself recognized the lower courts demanded "much-needed guidance."[142] Unless the lower courts can discover a way to use this opinion to develop a compromise solution, the judicial system must wait for another RICO/securities fraud case to appear and hope the Court does not again drop the ball.

V. CONCLUSION

In enacting the RICO statute, Congress included "fraud in the sale of securities" as a predicate offense with a meager amount of support and reasoning. Thus, courts interpreting RICO in securities fraud actions had little guidance as to whether the purchaser-seller standing limitation previously implied by the courts in a Rule 10b-5 action also applied to RICO. The ensuing confusion resulted in conflicting decisions among the federal circuits.

In *Holmes*, the SIPC attempted to recover monies paid to customers of two failed brokerage firms by bringing RICO charges against the defendant. Rather than decide the issue of whether the SIPC had standing to allege a RICO action, the Court held the actions by the defendant were not the proximate cause of the losses of the SIPC. The question of whether the purchaser-seller requirement applies to RICO remains unanswered. Thus, the federal courts may continue to interpret the issue

138. *See supra* text accompanying note 4.

139. Brodsky, *RICO And The Securities Laws*, *supra* note 130, at 7. The author summarized the arguments on both sides and concluded that the purchaser-seller requirement should not be eliminated.

140. Tobenkin, *supra* note 4, at 5 (referring to Holmes's attorney, who said that "lawyers may increasingly use the RICO law in securities violation cases far removed from the organized crime activities RICO was designed to fight against").

141. Brodsky, *RICO And The Securities Laws*, *supra* note 130, at 7.

142. Holmes v. Securities Investor Protection Corp., 112 S. Ct. 1311, 1322 (1992).

in the same manner as they did prior to *Holmes*, with some applying the purchaser-seller standing requirement to RICO cases, and others ignoring the standing requirement required by the securities laws.

In order to remain in harmony with Section 10b of the Securities Exchange Act of 1934 and Rule 10b-5, RICO needs to adopt the purchaser-seller requirement used by the federal securities laws in fraud actions. Limiting the number of potential plaintiffs will prevent frivolous RICO lawsuits and will constrain securities fraud actions to those that meet the criteria of the securities laws. By not addressing the purchaser-seller requirement, the Supreme Court avoided the most important issue in *Holmes*, and provided no direction for the divided lower courts. If potential defendants hoped for *Holmes* to clarify the liability picture, their wishes went unfulfilled, and they must wait for the next RICO case for another opportunity.