The Economics of Civil RICO

Paul H. Rubin and Robert Zwirb***

Much litigation under RICO has centered on the purpose and scope of the statute. Attempts by defendants and a number of courts to limit the reach of RICO by various means have generally met with failure. After Sedima, S.P.R.L. v. Imrex Co., Inc., *it is clear that RICO may be used by plaintiffs in almost all matters involving ordinary fraud, and in many commercial disputes as well. As a result, civil RICO enables private litigants to obtain treble damages for what are essentially civil wrongs, using civil standards of proof. Criminal offenses must be alleged, but need not be proven "beyond a reasonable doubt."*

This Article analyzes the economic efficiency of the civil RICO statute. The economic theory of crime indicates that the multiplied penalties are desirable when offenses are easily hidden and when overdeterrence is not a problem. Neither condition applies in many civil RICO cases. Thus, the Article concludes that there are substantial inefficiencies in the Act as now interpreted, and proposes alternative solutions.

INTRODUCTION

Much legal literature discusses RICO, the Racketeering Influenced Corrupt Organizations Act.[1] Yet none of it discusses the economics of

---

* Chief Economist, U.S. Consumer Product Safety Commission, and Adjunct Professor, George Washington University Law Center. Ph.D., Economics, Purdue University.

** Attorney, Federal Trade Commission. J.D., UCLA School of Law.

The views are the authors' and do not reflect the opinion of the Consumer Product Safety Commission, the Federal Trade Commission, or other members of their staffs.

[1] For recent examples, see Note, *Civil RICO is a Misnomer: The Need for Criminal Procedural Protections in Actions Under 18 U.S.C. § 1964*, 100 HARV. L. REV. 1288 (1987); Comment, Sedima v. Imrex: *Civil Immunity for Unprosecuted RICO Violators?*, 85 COLUM. L. REV. 419 (1985); *see also Report of the Ad Hoc Civil RICO Task Force*, 1985 A.B.A. SEC. CORP., BANKING & BUS. L.; Blakey, *The RICO Civil Fraud Action in Context: Reflections on* Bennett v. Berg, 58 NOTRE DAME L. REV. 237 (1982); Blakey & Gettings, *Racketeer Influenced and Corrupt Organizations (RICO):*

the statute. However, since a large body of economic literature deals with penalties for both criminal and civil wrongs, and with enforcement strategies, an economic analysis of RICO is possible. Such an analysis would be especially useful because this law is quite controversial. For example, in 1986 Congress debated and almost passed a major revision of the RICO statute.[2] An economic analysis would help illuminate the policy issues involved.

The RICO statute has four relevant features. First, the statute's remedies apply to virtually all businesses, not only to those criminal by nature. Second, private civil actions are involved. Third, damages are trebled. Finally, the standard of proof in RICO cases is "preponderance of the evidence," not "beyond a reasonable doubt."[3]

These features are unusual. Criminal prosecutions are by public, not private, prosecutors. In most civil actions, damages are actual, not multiplied. Moreover, in criminal cases, in which penalties may be greater than actual damages, the standard of proof is beyond a reasonable doubt, making conviction more difficult. Thus, this law has penalties and standards of proof usually associated with criminal law, but enforcement mechanisms usually associated with civil law. It applies to actions and firms usually subject to civil remedies.

This combination of features is susceptible to large inefficiencies. These inefficiencies occur partially because law enforcement resources are not allocated in the most efficient way. However, RICO's major efficiency cost is overdeterrence of efficient behavior. Antitrust is the only other major area with similar features. In antitrust, scholars have seriously questioned the trebling of penalties in private cases, for reasons similar to those advanced here.[4]

Basic Concepts — Criminal and Civil Remedies, 53 TEMP. L.Q. 1009 (1980); Miller & Olson, *The Expanding Uses of Civil RICO*, CAL. LAW. 12 (June 1984); Note, *Civil RICO: The Temptation and Impropriety of Judicial Restrictions*, 95 HARV. L. REV. 1101 (1982) [hereafter Note, *Judicial Restrictions*].

[2] *Why Business Couldn't Crack the Racketeering Law*, BUS. WK., Nov. 3, 1986, at 39; *Rico Restrictions Unravel As Congress Winds Down*, Washington Post, Oct. 16, 1986, at A19.

[3] *See* Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 491, *separate dissent*, 473 U.S. 523 (1985); Parnes v. Heinold Commodities, Inc., 487 F. Supp. 645, 647 (N.D. Ill. 1980).

[4] *See* Breit & Elzinga, *Private Antitrust Enforcement: The New Learning*, 28 J. L. & ECON. 405 (1985); Easterbrook, *Detrebling Antitrust Damages*, 28 J. L. & ECON. 445 (1985); Landes, *Optimal Sanctions for Antitrust Violations*, 50 U. CHI. L. REV. 652 (1983); Schwartz, *An Overview of the Economics of Antitrust Enforcement*, 68 GEO. L.J. 1075 (1980); Polinsky, *Detrebling versus Decoupling Antitrust Damages*, Working Paper No. 25, Stanford Law School, Law and Economics Program, January,

Parts I and II of this Article discuss the legal issues involved in civil RICO enforcement: first the statute and then the case law. The discussion concentrates on the legal basis for the four features identified as economically significant. The major legal battles have been over the first issue mentioned above — the types of behaviors and businesses covered by the law. Part III discusses the economics of RICO. Part IV discusses in more detail some typical cases and indicates their relationship to the economic analysis. Part V summarizes RICO's status and discusses policy implications.

I. THE STATUTE

RICO[5] contains both criminal[6] and civil[7] provisions for violating the Act's substantive provisions.[8] The civil damage provision[9] creates a private right with treble damage recovery for "[a]ny person injured in his business or property by reason of a violation of [section 1962]."[10] Section 1962(c) of RICO prohibits participation by "any person"[11] in the conduct of an "enterprise"[12] through a "pattern of racketeering activity,"[13] which is defined as consisting of at least two occurrences of any

---

1986.

[5] RICO is actually part of the Organized Crime Control Act of 1970, Pub. L. No. 91-452, 84 Stat. 922 (codified at 18 U.S.C. §§ 1961-1968 (1984)), and appears as Title IX of that Act, 84 Stat. 941.

[6] *See* 18 U.S.C. § 1963 (1984).

[7] *See id.* § 1964.

[8] *See id.* § 1962.

[9] *Id.* § 1964(c).

[10] Section 1964(c) states in full:

> Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee.

Section 1962 prohibits the use of income derived from (1) a pattern of racketeering activity aimed at acquiring an interest in or establishing an interstate commerce enterprise; (2) the acquisition or maintenance of any interest in an enterprise through a pattern of racketeering activity; (3) conducting or participating in an enterprise's conduct through a pattern of racketeering activity; or (4) conspiring to engage in these activities.

[11] The term "person" includes "any individual or entity capable of holding a legal or beneficial interest in property." 18 U.S.C. § 1961(3) (1984).

[12] The term "enterprise" includes "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.* § 1961(4).

[13] The term "pattern of racketeering activity" requires two acts of racketeering activity occurring within ten years of each other, one of which occurred after the effective

of several offenses.[14] "Racketeering acts" consist of a wide range of both federal and state offenses including such mob-related activities as murder, kidnapping, gambling, arson, robbery, bribery, extortion, and certain drug offenses. However, other offenses include mail, wire, and securities fraud. The individual acts of racketeering activity are known as "predicate offenses."[15]

Civil RICO thus prohibits a person from participating in an enterprise's affairs through a pattern of racketeering activity. While the statute is complicated, the essence of a RICO violation, according to the Supreme Court, "is the commission of . . . [at least two predicate acts] in connection with the conduct of an enterprise."[16]

In contrast to the strict construction policy normally applied in criminal law matters, the RICO statute explicitly states that it is to "be liberally construed to effectuate its remedial purposes."[17] Finally, the Supreme Court has ruled that the predicate acts need not be established beyond a reasonable doubt, but by a preponderance of evidence.

II. The Case Law

The RICO statute has prompted much litigation. From a purely legal point of view, the controversies litigated in civil RICO cases have centered on the issue of what comprises a RICO claim. Underlying this issue are different viewpoints as to the statute's purpose and appropriate application. Much of the RICO litigation has centered on these two important and overlapping concerns. In the past decade, as more RICO cases have arisen, a debate has developed concerning RICO's application to ordinary commercial transactions and to parties not connected

---

date of RICO (Oct. 15, 1970). *Id.* § 1961(5).

[14] The predicate offenses are listed in 18 U.S.C. § 1961(1) (1984), and are considered acts of "racketeering activity."

[15] A defendant need not be *convicted* of committing two predicate acts to be liable under the civil RICO provisions. Section 1961 requires only the commission of any act that is: 1) "chargeable" under the generally described state laws, 2) "indictable" under the listed federal laws, or 3) an "offense" involving bankruptcy, drug-related activities, or securities fraud. *See* Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, *separate dissent*, 473 U.S. 523 (1985).

[16] *Sedima*, 473 U.S. at 497. While two predicate acts are necessary, they may not be sufficient; and two isolated acts of racketeering do not constitute a "pattern" according to the Supreme Court. *Id.* at 496 n.14. On the other hand, each act — such as each mailing in a fraud scheme — is counted as an offense of racketeering activity. *See* United States v. Weatherspoon, 581 F.2d 595, 601-02 (7th Cir. 1978). Moreover, the two predicate acts need not be related to each other, but must be intended to further the enterprise's affairs. United States v. Phillips, 664 F.2d 971, 1011-12 (5th Cir. 1981).

[17] Pub. L. No. 91-452, § 904(a), 84 Stat. 947 (1970).

with organized crime. Some of the issues that have been litigated extensively pertain to what type of plaintiffs may bring civil RICO suits against what type of defendants, and what type of practices the statute covers. In a more general sense, the legal issues relate to the scope of RICO's private penalty provisions and to their possible limitations.

However, the Act's contours are heavily influenced by the underlying purpose of the statute, an issue that provokes sharp disagreements. Until recently, there was no consensus regarding RICO's purpose, what it required, and how far it extended. The situation had reached the point where one commentator described the unresolved state of affairs as one of "equipoise."[18] The Supreme Court finally resolved some of these issues in 1985 in *Sedima, S.P.R.L. v. Imrex Co., Inc.*[19] This decision caused courts to interpret the statute quite liberally.

A. Purpose

Many courts in early decisions were troubled by RICO's increased use against ordinary businesses, the reputational harm that a criminal racketeering statute caused, and the extortionate potential such a statute had on defendants. The Second Circuit in *Sedima* summarized these concerns regarding RICO's purpose:

> [A] broad reading of the civil RICO provisions would allow plaintiffs to bring suit in federal court under RICO nearly anytime they could allege injury caused by two acts which are violations of any one of the predicate acts listed in RICO. Since these predicate acts include a great many state law violations, federal securities law violations, and federal mail and wire fraud violations, an expansive interpretation of RICO allows plaintiffs to bring into federal courts many claims formerly subject only to state jurisdiction, and to bypass remedial schemes created by Congress, particularly in the securities area. The fact that successful RICO plaintiffs may obtain treble damages and attorneys' fees provides, of course, additional incentives to plaintiffs to categorize their actions as RICO claims.[20]

Most courts — including those taking a broad view of RICO's purpose — have been troubled by the lure that RICO's treble damage provision creates for opportunistic plaintiffs. Courts have described the incentive as a "windfall recovery,"[21] "a runaway . . . bonanza for the

---

[18] Abrams, *The Place of Procedural Control in Determining Who May Sue or Be Sued: Lessons in Statutory Interpretation from Civil RICO and* Sedima, 38 VAND. L. REV. 1477, 1479 (1985).

[19] 473 U.S. 479 (1985).

[20] *Sedima*, 741 F.2d 482, 486 (2d Cir. 1984) (footnote omitted).

[21] Bankers Trust Co. v. Feldesman, 566 F. Supp. 1235, 1241 (S.D.N.Y. 1983); *see also Sedima*, 574 F. Supp. 963, 965 (E.D.N.Y. 1983), *aff'd*, 741 F.2d 482 (2d Cir.

already excessively litigious,"[22] and "the model of a treasure hunt."[23] Other courts have been offended by what they regard as the inappropriate application of a statute aimed at racketeers and racketeering activity. For example, the Second Circuit protested: "Given the general purpose of the RICO legislation, the uses to which private civil RICO has been put have been extraordinary, if not outrageous."[24]

Some courts have sought ways to limit the application of RICO. One obvious way is to construe its purpose narrowly. Typical is the opinion of a federal district court in Massachusetts which stated that courts "have avoided a slavish literalism that would escort into federal court through RICO what traditionally have been civil actions pursued in state courts."[25]

Other courts ignore the statute's language. One district court, for example, dismissed the plaintiff's RICO claims despite acknowledging that they "seem to be authorized by the Act."[26] The Court defended its dismissal by quoting from a 19th century case:

> This acknowledgment, of course, does not end the inquiry for it "is a 'familiar rule, that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers.' "[27]

Courts that narrowly construe RICO's purpose maintain that its central purpose was to counteract the activities of organized crime, and in particular organized crime's infiltration into legitimate businesses.[28]

1984), *rev'd*, 473 U.S. 479, *separate dissent*, 473 U.S. 523 (1985).

[22] Schacht v. Brown, 711 F.2d 1343, 1361 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983).

[23] Sutliff, Inc. v. Donovan Cos., 727 F.2d 648, 652 (7th Cir. 1984).

[24] *Sedima*, 741 F.2d at 487.

[25] Van Schaick v. Church of Scientology, Inc., 535 F. Supp. 1125, 1136 (D. Mass. 1982).

[26] Adair v. Hunt Int'l Resources Corp., 526 F. Supp. 736, 746 (N.D. Ill. 1981).

[27] *Id.*

[28] According to the Senate Report accompanying the Organized Crime Control Act of 1970, RICO's purpose was to "eliminat[e] . . . the infiltration of organized crime and racketeering into legitimate organizations operating in interstate commerce." S. REP. NO. 617, 91st Cong., 1st Sess. 76 (1969). Various courts and Justices have reaffirmed this view. For example, Justice Powell in his dissent in *Sedima* states "that the 'declared purpose' of Congress in enacting the RICO statute was 'to seek the eradication of organized crime in the United States.' " 473 U.S. at 508. And Justice Marshall, in a separate dissent, wrote that RICO's "principal target was the economic power of racketeers, and its toll on legitimate businessmen." *Id.* at 531; *see also Sedima*, 741 F.2d at 487 ("The Racketeer Influenced and Corrupt Organization Act, as its very name implies, was designed to combat organized crime."); Harper v. New Japan Sec. Int'l, Inc., 545 F. Supp. 1002, 1004 (C.D. Cal. 1982) ("RICO is primarily a criminal

Moreover, these courts maintain that RICO was not intended to replace existing state and federal law remedies,[29] nor was it intended to apply to "garden variety fraud."[30] In addition, if RICO were applied more generally, plaintiffs could get around the stricter or less generous legal standards (including standing, culpability, causation, reliance, materiality) of statutes covering the underlying predicate acts.[31] For example, RICO's ten year statute of limitations would permit actions for securities fraud barred by federal securities acts'[32] three year limitation. Courts have criticized the treble damage penalty and award of attorney fees as an enticing incentive for plaintiffs to bring RICO actions,[33] while the stigma of being labelled a "racketeer" plus the threat of large penalties allegedly coerces businesspeople into settling claims they might ordinarily resist.[34] Finally, the cumulative effect of these incen-

---

statute aimed specifically at curtailing the infiltration of business enterprises by organized crime.").

[29] *See, e.g., Sedima*, 741 F.2d at 492:

> If Congress had intended to provide a federal forum for plaintiffs for so many common law wrongs, it would at least have discussed it. If Congress had intended to provide an alternate and more attractive scheme for private parties to remedy violations of the securities laws — involving decades of statutes, regulations, commentaries, and jurisprudence — it would at least have mentioned it.

See also Bankers Trust Co. v. Feldesman, 566 F. Supp. 1235, 1241 (S.D.N.Y. 1983) (RICO "was simply not intended to provide a plaintiff with a windfall recovery for ordinary injuries that are otherwise compensable.").

[30] *See infra* text accompanying notes 49-57.

[31] *See* Justice Marshall's separate dissenting opinion in *Sedima*, 473 U.S. at 523 ("plaintiffs can avoid the limitations of the securities laws merely by alleging violations of other predicate acts [under RICO]").

[32] Bache Halsey Stuart Shields v. Tracy Collins Bank, 558 F. Supp. 1042, 1046 (D. Utah 1983). The Court pointed out that RICO requires only that two predicate acts be committed within ten years of each other. The statute of limitations for mail fraud is five years after the offense was committed, 18 U.S.C. § 3282 (1985); the statute of limitations for private damages in certain states under section 10b-5 of the Securities Exchange Act of 1934 is three years (15 U.S.C. 78j(b)(1981)). Thus a party is liable for mail fraud two times longer under RICO and for securities law violations three times longer under RICO.

[33] *See* Harper v. New Japan Sec. Int'l, Inc., 545 F. Supp. 1002, 1007-08 (C.D. Cal. 1982) ("It is simply incomprehensible that a plaintiff suing under the securities laws would receive one-third the damages of a plaintiff suing under RICO for the same injury."); *see also Sedima*, 741 F.2d at 486.

[34] As explained by Justice Marshall, a civil RICO defendant faced with "a tremendous financial exposure in addition to the threat of being labelled a 'racketeer,' will have a strong interest in settling the disputes." *Sedima*, 473 U.S. at 523 (Marshall, J., separately dissenting). Marshall concludes that plaintiffs use civil RICO "for extortive purposes," *id.* at 527, and notes with some irony that RICO has given "rise to the very

tives to sue combined with private enforcement of the statute is said to encourage "overbroad use of RICO."[35] Further, RICO is untamed by the institutional forces that normally limit the use of criminal-based

---

evils it was designed to combat," *id.* In *Sedima*, 741 F.2d at 486-87, the court of appeals commented:

> We are told that there is now indeed a "RICO bar" which specializes in bringing or defending RICO claims. And members of that "bar" have found, as would appear obvious, that the stigma associated with the label "racketeering" is a good settlement weapon. Indeed, a current adage is said to be that "RICO provides the only civil action where the defendant pleads not guilty (footnote omitted)."

While the complaint that RICO is being used as a "settlement weapon" has troubled some courts, it does not appear to have been a factor in deciding any cases, especially given the more important charges that RICO is being misused or that it was intended only to apply to organized crime-related activity. One court, nevertheless, faced this issue head on, and turned it on its ear:

> A number of courts dismayed by civil RICO have commented on the *in terrorem* settlement value that the threat of treble damages may add to spurious claims. After all, the line between fraud and mistake or misunderstanding can be a very fine one. It is, therefore, important that, in the further development of civil RICO, criminal fraud be clearly distinguished from less egregious conduct. On the other side of the scales, however, is another phenomenon with which lawyers and courts are also familiar. The delays, expense and uncertainties of litigation often compel plaintiffs to settle completely valid claims for a mere fraction of their value. By adding to the settlement value of such valid claims in certain cases clearly involving criminal conduct, RICO may arguably promote more complete satisfaction of plaintiffs' claims without facilitating indefensible windfalls.

Haroco, Inc. v. American Nat'l Bank & Trust Co., 747 F.2d 384, 399 n.16 (7th Cir. 1984), *aff'd*, 473 U.S. 606 (1985).

[35] *Sedima*, 741 F.2d at 497. In *Sedima*, the Second Circuit Court of Appeals noted that there was an "explosion" of private civil RICO litigation due to the incentives created by the law and the fact that there was nothing comparable to prosecutorial discretion of public officials in private RICO. 741 F.2d at 486-87. These views were echoed by Justice Powell in his dissenting opinion to the Supreme Court's decision in *Sedima*, 473 U.S. at 521 ("Typically, these suits are being brought — in the unfettered discretion of private litigants — in federal court against legitimate businesses seeking treble damages in ordinary fraud and contract cases. There is nothing comparable in those cases to the restraint on the institution of criminal suits exercised by government prosecutorial discretion . . . [this] inevitably will encourage continued expansion of resort to RICO in cases of alleged fraud or contract violation rather than to the traditional remedies available in state court"); and by Justice Marshall in his separate dissent to that decision, 473 U.S. at 526 ("In the context of civil RICO . . . the restraining influence of prosecutors is completely absent. Unlike the Government, private litigants have no reason to avoid displacing state common-law remedies. Quite to the contrary such litigants lured by the prospect of treble damages and attorney's fees, have a strong incentive to invoke RICO's provisions whenever they can allege in good faith two instances of mail or wire fraud").

statutes.

Ultimately most courts, and finally in 1985 the Supreme Court, rejected these attempts to narrowly construe RICO's purpose. While proclaiming that RICO was designed to counteract more than organized crime's infiltration into the legitimate business world, these later decisions acknowledged that such an interpretation did depart from RICO's central purpose. Typical was the Supreme Court's characterization in *Sedima*: "We nonetheless recognize that, in its private civil version, RICO is evolving into something quite different from the original conception of its enactors."[36] The courts, nevertheless, concluded that the statute's language, congressional intent, and constitutional reasons made a narrow interpretation inappropriate. In a widely cited passage, the Seventh Circuit defended its adoption of a broad interpretation:

> The root of the conflict seems to lie in the fact that, in RICO, we confront a statute which is not ambiguous but which is, above all, deliberately and extraordinarily broad. There are some ambiguities, to be sure, but the fact that RICO has been applied in situations not expressly anticipated by Congress does not demonstrate ambiguity. It demonstrates breadth.[37]

Courts have also noted that RICO is a "functional" statute designed to counter certain *practices* rather than attack certain types of criminals.[38]

---

[36] *Sedima*, 473 U.S. at 507.

[37] *Haroco*, 747 F.2d at 398. *Haroco* was one of many "prime rate" cases in which the plaintiff alleged that a bank was defrauding it in calculating the interest rate on a variable rate loan. In these cases, the defendants usually argued that Congress did not intend that RICO be used in such situations. The Seventh Circuit, however, answered by stating:

> With respect to the case before us, it does not seem at all likely that Congress anticipated the application of civil RICO to improperly calculated interest charges by a commercial bank. And this may or may not be an appropriate subject for this federal statute. Nevertheless, it does not seem fitting for us to attempt to narrow the statute in ways which are nearly impossible to rationalize merely to exclude subjects of this kind. For to say that Congress did not anticipate this subject is not to say that Congress would have excluded it if the subject had been brought explicitly to its attention. Congress appears to have preferred a broad statute, even if over-inclusion might result.

Id. at 399.

[38] *See* Furman v. Cirrito, 741 F.2d 524, 530 (2d Cir. 1984) ("By defining 'racketeering activity' in functional rather than status terms, [C]ongress sought to avoid serious constitutional hazards."); *see also* Crocker Nat'l Bank v. Rockwell Int'l Corp., 555 F. Supp. 47, 49 (N.D. Cal. 1982): "Congress did not . . . limit the scope of RICO to persons connected with organized crime (citation omitted) or even to those activities that are commonly thought of as racketeering (citation omitted). Instead, Congress focused on particular activities and provided remedies against persons engaging in them."

Finally, they have noted that given the apparent breadth of the RICO statute, any narrowing should come from Congress rather than the judiciary.[39]

In various judicial discussions of civil RICO's underlying purpose, courts have also discussed two arguments raised by defendants: 1) that RICO stigmatizes respected businesspeople as "racketeers"; and 2) that courts are applying it inappropriately to "garden variety" fraudulent conduct rather than to hard core racketeering activity.

1. Stigma

Businesspeople defending themselves in civil RICO suits have expressed extreme displeasure with being labelled — even if only allegedly — "racketeers," and having to defend themselves under a statute aimed at combatting organized crime. Many cases, therefore, place "the sensibilities of prominent defendants alleged to be 'racketeers' "[40] into issue. In one case, parties responding to RICO allegations complained "that it is scandalous, impertinent, and indecent" to have to defend themselves against such allegations "because they essentially accuse[d] . . . [them] of being criminals and thus damaged their reputations."[41] Not only businesspeople were disturbed by the increasing application of RICO to commercial disputes. Justice Powell, dissenting in *Sedima*, complained: "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

---

[39] *Sedima*, 473 U.S. at 507: "It is true that private civil actions under the statute are being brought almost solely against [respected businesses], rather than against the archetypal, intimidating mobster. Yet this defect — if defect it is — is inherent in the statute as written, and its correction must lie with Congress" (footnote omitted). *See also* Schacht v. Brown, 711 F.2d 1343, 1354-55 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983): "Congress chose to provide civil remedies for an enormous variety of conduct, balancing the need to redress a broad social ill against the virtues of tight, but possibly overly astringent, legislative draftsmanship. It is not for this court to reassess the balance struck."

The courts also refused to second guess the preferences of Congress by performing a cost-benefit analysis. *See* Schacht v. Brown, 711 F.2d at 1361 ("it is not our role to reassess the costs and benefits associated with the creation of a dramatically expansive, and perhaps insufficiently discriminate, tool for combating organized crime"); Mauriber v. Shearson/Am. Express, Inc., 567 F. Supp. 1231, 1240 (S.D.N.Y. 1983) ("I do not believe that the wide spread abuse of the civil provisions can be checked by the judiciary writing in a limitation which Congress deliberately and knowingly chose to omit.").

[40] *Haroco*, 747 F.2d at 399.

[41] Heinold Commodities, Inc. v. McCarty, 513 F. Supp. 311, 313 (N.D. Ill. 1979).

of the statute."[42] And the Second Circuit Court of Appeals expressed dismay in RICO claims being made "against such respected and legitimate 'enterprises' as the American Express Company, E.F. Hutton & Co., Lloyd's of London, Bear Stearns & Co. and Merrill Lynch."[43]

Other courts and judges, however, have been less troubled by the "stigmatization" of respected businesspeople, pointing out that the statute is aimed at certain *practices* and cares little who commits them.[44] Some courts are even nonchalant about the reputational harm RICO suits cause,[45] while others assert that the defendants deserve any dam-

---

[42] *Sedima*, 473 U.S. at 511 (Powell, J., dissenting).

[43] *Sedima*, 741 F.2d at 487 (footnote omitted).

[44] In Furman v. Cirrito, 741 F.2d 524, 530 (2d Cir. 1984), the Second Circuit stated:

> Defendants and others have decried the use of RICO in "far-reaching civil contexts" where it has the potential to "tarnish the reputations" of ostensibly legitimate businesspersons. We are unmoved by the argument. By defining "racketeering activity" in functional rather than statutory terms, Congress sought to avoid serious constitutional hazards. If defendants are surprised or offended that their "garden variety" fraudulent conduct is now statutorily characterized as "racketeering," they should address their grievance to Congress, which clearly and specifically included mail, wire, and securities frauds as predicate acts of "racketeering activity". . . .

See also Crocker Nat'l Bank v. Rockwell Int'l Corp., 555 F. Supp. 47, 49 (N.D. Cal. 1982).

[45] *See* Taylor v. Bear Stearns & Co., 572 F. Supp. 667, 682 (N.D. Ga. 1983) ("Finally, a 'court's preoccupation with possible implications of links to organized crime is self-fulfilling; RICO claims can stigmatize defendants only if courts restrict the applicability of the broad statutory language to proven organized criminals.' " (quoting Note, *Judicial Restrictions*, *supra* note 1, at 1107)). In *Sedima*, 741 F.2d at 508, Judge Cardamone argued in dissent:

> Further, the majority's sensitivity to the stigma that may attach to decent citizens named as defendants in civil RICO cases seems a bit overstated. Today, defendants in civil suits are labelled as violators of environmental laws when pumping coal by-products into the atmosphere, despoilers of our rivers when emptying oil from their tanker's bilges, adulterers in state divorce actions, and killers in vehicular wrongful death actions. The allegations of the civil complaint do not make these citizens criminals, although their conduct may well subject them to separate criminal prosecutions. Why the outcry over RICO? I, for one, believe the public is sophisticated enough to distinguish between a criminal conviction and a civil claim. To be named as a RICO defendant is not quite the Sword of Damocles that the majority would have it. Repeated often enough, it will either lose its effect as a settlement weapon or create enough public pressure to cause Congress to amend the statute. Again, it is not for this Court to alter the statute.

aging stigma that attaches.[46] In any case, the Supreme Court has twice answered the question of whether corporate executives can be regarded as racketeers. It stated simply that RICO applies to both "legitimate" and "illegitimate" enterprises,[47] and further noted that "[t]he former enjoy neither an inherent incapacity for criminal activity nor immunity from its consequences."[48]

2. "Garden Variety" Fraud

Whether civil RICO was intended to combat ordinary business or "garden variety" fraud is closely intertwined with the larger issue of purpose. It is, therefore, not surprising that those courts narrowly construing RICO's mission also hesitated to apply it to typical business fraud cases and breach of contract involving banks, securities firms, real estate developers, and the like.[49] Opinions narrowly construing RICO stated either that Congress did not intend RICO to apply in "garden variety" cases,[50] or that adequate remedies at common law or in federal statutes already existed.[51]

Most courts, however, have applied RICO to claims based on common law fraud and on violations of securities laws.[52] These courts have

---

[46] *See Furman*, 741 F.2d at 529 ("It seems almost too obvious to require statement, but fraud is fraud, whether it is committed by a hit man for organized crime or by the president of a Wall Street brokerage firm.").

[47] United States v. Turkette, 452 U.S. 576, 580-81 (1981). In *Turkette* the issue was whether RICO applied to criminal enterprises. The Supreme Court said yes, noting that RICO "no more excludes criminal enterprises than it does legitimate ones." *Id.* at 580-81. It was already assumed by all parties, in other words, that RICO applies to *legitimate* enterprises. *Id.*

[48] *Sedima*, 473 U.S. at 507. Ironically, in *Sedima* the assumption was that RICO applied to criminal enterprises, but the Court felt obliged to address whether it *also* applied to legitimate enterprises. *Id.*

[49] *See, e.g.*, *Sedima*, 741 F.2d at 487; Trane Co. v. O'Connor Secs., 718 F.2d 26, 28 n.3 (2d Cir. 1983) ("[A] growing number of courts have held that private civil RICO actions cannot be used to turn garden-variety securities law violations into racketeering violations under RICO."); Adair v. Hunt Int'l Resources Co., 526 F. Supp. 736 (N.D. Ill. 1981) (RICO not alternative remedy for plaintiff's alleging securities fraud or misrepresentations in context of real estate transactions).

[50] *See Adair*, 526 F. Supp. at 747 ("There simply is no hint in the congressional proceedings that the Act was viewed as an alternative, and cumulative remedy for private plaintiffs alleging securities fraud or misrepresentations in the context of real estate transactions.").

[51] *See id.* at 748; *see also Sedima*, 473 U.S. at 524 (Marshall, J., dissenting).

[52] *See, e.g.*, Moss v. Morgan Stanley, Inc., 719 F.2d 5, 20-21 (2d Cir. 1983) (shareholder's sale of stock on open market prior to tender offer announcement); *see also* USACO Coal Co. v. Carbomin Energy, Inc., 689 F.2d 94, 95-96 (6th Cir. 1982) (cor-

emphasized that Congress intentionally "cast the net of liability wide"[53] not only to completely suppress organized crime, but also to combat fraudulent practices.[54] One court bluntly stated that "fraud is fraud, whether it is committed by a hit man for organized crime or by the president of a Wall Street brokerage firm."[55] Moreover, these decisions emphasize that a RICO plaintiff must prove much more than ordinary fraud to prevail — she must also show that the fraud resulted from a "pattern of racketeering activity" used to conduct the enterprise's affairs.[56]

The Supreme Court appears to have put the issue to rest in its *Sedima* decision. While acknowledging that RICO is evolving away from Congress' original conception, *Sedima* held that the statute's breadth makes the outcome unavoidable.[57]

B. Limitations on Application of RICO

Besides battling over RICO's purpose, litigants have debated extensively its scope and reach. In fact, the typical RICO case concerns whether one or more purported limitations of the Act apply. Generally, attempts by defendants and some courts to read limitations into the Act have met the same unsuccessful fate as their attempts to narrow the Act's purpose. In particular, the courts have considered three limitations: 1) whether RICO requires a connection between the challenged

---

porate promoter diverted funds for personal use); Mauriber v. Shearson/Am. Express, Inc., 546 F. Supp. 391, 396 (S.D.N.Y. 1982) ("Racketeering activity under RICO specifically includes 'fraud in the sale of securities.' ").

[53] Sutliff, Inc. v. Donovan Co., 727 F.2d 648, 654 (7th Cir. 1984).

[54] *See* Furman v. Cirrito, 741 F.2d 524, 529 (2d Cir. 1984):

> Congress was well aware that . . . it was . . . elevating "garden variety" common law fraud claims to the status of federal offenses, and subjecting violators to enhanced criminal penalties and severe civil remedies . . . When congress provided severe sanctions, both civil and criminal, for conducting the affairs of an "enterprise" through a "pattern of racketeering activity," it provided no exception for businessmen, for white collar workers, for bankers, or for stockbrokers. If the conduct of such people can sometimes fairly be characterized as "garden variety fraud," we can only conclude that by the RICO statute Congress has provided an additional means to weed that "garden" of its fraud.

[55] *Id.* at 529.

[56] *Id.* at 529-30.

[57] *See Sedima*, 473 U.S. at 507 ("The 'extraordinary' uses to which civil RICO has been put appear to be primarily the result of the breadth of the predicate offenses, in particular the inclusion of wire mail, and securities fraud, and the failure of Congress, and the courts to develop a meaningful concept of 'pattern.' ").

activity and organized crime; 2) whether plaintiffs must allege a special kind of injury beyond what the predicate acts themselves cause — referred to as a "RICO-type," or "racketeering," or "competitive" injury; and 3) whether prior criminal convictions for the predicate acts must underlie the RICO allegations.

1. Organized Crime Nexus

The contention that the challenged activity must have a nexus with organized crime is really the flipside of the argument that RICO's sole purpose was to combat organized crime. While some district courts have accepted this argument,[58] most courts have rejected it, citing legislative history, constitutional difficulties with such a limitation, and problems that such a limitation would create for plaintiffs in proving RICO violations.[59] Although the Supreme Court in *Sedima* did not address this issue, its explicit tolerance of RICO actions against "respected businesses"[60] leaves little doubt that an organized crime connection is unnecessary.

---

[58] *See* Hokama v. E.F. Hutton & Co., 566 F. Supp. 636, 643-44 (C.D. Cal. 1983); Moss v. Morgan Stanley, Inc., 553 F. Supp. 1347, 1358-62 (S.D.N.Y. 1983), *aff'd on other grounds*, 719 F.2d 5 (2d Cir. 1983); Noonan v. Granville-Smith, 537 F. Supp. 23, 29 (S.D.N.Y. 1981); Waterman S.S. Corp. v. Avondale Shipyards, Inc., 527 F. Supp. 256, 260 (E.D. La. 1981); Adair v. Hunt Int'l Resources Corp., 526 F. Supp. 736, 747 (N.D. Ill. 1981); Barr v. WUI/TAS, Inc., 66 F.R.D. 109, 112-13 (S.D.N.Y. 1975) (plaintiffs could not allege RICO violations unless they showed defendant's membership in "a society of criminals operating outside of the law").

[59] *See* Haroco, Inc. v. American Nat'l Bank & Trust Co., 747 F.2d 384, 400-02 (7th Cir. 1984), *aff'd*, 473 U.S. 606 (1985); Sutliff, Inc. v. Donovan Co., 727 F.2d 648, 654 (7th Cir. 1984); Moss v. Morgan Stanley, Inc., 719 F.2d 5, 21 (2d Cir. 1983), Bunker Ramo Corp. v. United Business Forms, Inc., 713 F.2d 1272, 1287 n.6 (7th Cir. 1983); Schacht v. Brown, 711 F.2d 1343, 1356 (7th Cir.), *cert denied*, 464 U.S. 1002 (1983); Bennett v. Berg, 685 F.2d 1053, 1063-64 (8th Cir. 1982); United States v. Campanale, 518 F.2d 352, 363-64 (9th Cir. 1975); Oklahoma v. Children's Shelter, Inc., 604 F. Supp. 867, 869 (W.D. Okla. 1985); Taylor v. Bear Stearns & Co., 572 F. Supp. 667, 681-82 (N.D. Ga. 1983); Mauriber v. Shearson/Am. Express, Inc., 567 F. Supp. 1231, 1239 (S.D.N.Y. 1983) (amended complaint); Kimmel v. Peterson, 565 F. Supp. 476, 490-93 (E.D. Pa. 1983); Windsor Assocs. v. Greenfield, 564 F. Supp. 273, 276-78 (D. Md. 1983); Crocker Nat'l Bank v. Rockwell Int'l Corp., 555 F. Supp. 47, 49 (N.D. Cal. 1982); Hellenic Lines, Ltd. v. O'Hearn, 523 F. Supp. 244, 247-48 (S.D.N.Y. 1981).

[60] *See Sedima*, 473 U.S. at 507: "It is true that private civil actions under the statute are being brought almost solely against such defendants, rather than the archetypal intimidating mobster. Yet this defect — if defect it is — is inherent in the statute as written, and its correction must lie with Congress (footnote omitted)."

2. "Racketeering" Injury

After rejection of the "organized crime" connection, RICO defendants and some courts proposed other theories to limit the statute's scope. Among the offered theories was that a RICO claim required a special type of injury. Analogizing to the special injury ("antitrust injury") required by antitrust laws, some courts reasoned that RICO claims required a "competitive injury."[61] Courts have described such an injury as one "to business or property stemming from competitive harm,"[62] or one in which the injured party "is forced to compete with an enterprise that has gained an unfair market advantage through the infusion of funds from racketeering activity."[63] Despite the appeal of the antitrust injury analogy, most courts that have considered the competitive injury requirement have rejected it.[64]

Courts have also used the antitrust injury analogy to advance the theory that plaintiffs must allege a "racketeering enterprise injury."[65] Also referred to as a "RICO-type" injury, a court has described such a requirement as an injury "different in kind from that occurring as a result of the predicate acts themselves,"[66] or one resulting from "an activity which RICO was designed to deter."[67] It generally refers to some injury above and beyond and different from what the predicate

---

[61] *E.g.*, Bankers Trust Co. v. Feldesman, 566 F. Supp. 1235, 1241 (S.D.N.Y. 1983); North Barrington Dev., Inc. v. Fanslow, 547 F. Supp. 207, 211 (N.D. Ill. 1980) ("plaintiff must allege how it was injured competitively by the RICO violation in order to state a cause of action under § 1964(c)").

[62] *Sedima*, 741 F.2d at 485.

[63] *Sedima*, 574 F. Supp. at 965.

[64] *See* Haroco, Inc. v. American Nat'l Bank & Trust Co., 747 F.2d 384, 391 (7th Cir. 1984), *aff'd*, 473 U.S. 606 (1985) ("While a competitive injury might be *sufficient* to sustain a RICO claim, a competitive injury is . . . not *necessary* to state a RICO claim." (emphasis in original)); *Sedima*, 741 F.2d at 496; Schacht v. Brown, 711 F.2d 1343, 1357 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983); Bennett v. Berg, 685 F.2d 1053, 1059 (8th Cir. 1982); *In re* Catanella & E.F. Hutton & Co. Sec. Litig., 583 F. Supp. 1388, 1431-32 (E.D. Pa. 1984); Mauriber v. Shearson/Am. Express, Inc., 567 F. Supp. 1231, 1240 (S.D.N.Y. 1983); Kimmel v. Peterson, 565 F. Supp. 476, 493-95 (E.D. Pa. 1983); Crocker Nat'l Bank v. Rockwell Int'l Corp., 555 F. Supp. 47, 49 (N.D. Cal. 1982); Van Schaick v. Church of Scientology, Inc., 535 F. Supp. 1125, 1137 n.11 (D. Mass. 1982); Hellenic Lines, Ltd. v. O'Hearn, 523 F. Supp. 244, 248 (S.D.N.Y. 1981).

[65] According to one court, such an injury occurs when "a civil RICO defendant's ability to harm the plaintiff is enhanced by the infusion of money from a pattern of racketeering activity into the enterprise." Landmark Sav. & Loan v. Rhoades, 527 F. Supp. 206, 209 (E.D. Mich. 1981).

[66] *Sedima*, 741 F.2d at 496.

[67] *Id.* at 494.

acts themselves cause.

As with other attempts to limit RICO's scope, even courts within the same circuit have split on the racketeering injury requirement.[68] While some courts (mainly district courts) imposed this requirement on plaintiffs,[69] most courts generally rejected it.[70] Some courts have complained about the racketeering injury requirement's lack of definition,[71] while one judge remarked that it was "no more than a euphemism for an 'organized crime' nexus."[72] In *Sedima*, the Supreme Court put this issue to rest by rejecting a racketeering injury requirement and ruling that an injury resulting from commission of the predicate acts alone will sustain a RICO claim.[73]

---

[68] *Compare* Bankers Trust Co. v. Rhoades, 741 F.2d 511, 516-17 (2d Cir. 1984) (plain meaning requires distinct RICO injury) *with* Furman v. Cirrito, 741 F.2d 524, 528 (2d Cir. 1984) (language is clear and does not require racketeering injury).

[69] *See Sedima*, 741 F.2d at 496-97; Modern Setting, Inc. v. Prudential Bache Sec., 603 F. Supp. 370 (S.D.N.Y. 1985); Furman v. Cirrito, 578 F. Supp. 1535, 1540-41 (S.D.N.Y. 1984); Haroco, Inc. v. American Nat'l Bank & Trust Co., 577 F. Supp. 111, 114-15 (N.D. Ill. 1983), *rev'd*, 747 F.2d 384 (7th Cir. 1984), *aff'd*, 473 U.S. 606 (1985); Barker v. Underwriters at Lloyd's, London, 564 F. Supp. 352, 358 (E.D. Mich. 1983); Harper v. New Japan Sec. Int'l, Inc., 545 F. Supp. 1002, 1007-08 (C.D. Cal. 1982); Van Schaick v. Church of Scientology, Inc., 535 F. Supp. 1125, 1136, 1137 n.11 (D. Mass. 1982); Landmark Savs. & Loan v. Rhoades, 527 F. Supp. 206, 208-09 (E.D. Mich. 1981).

[70] *See, e.g., Furman*, 741 F.2d at 528; United States v. Thordarson, 646 F.2d 1323, 1328 (9th Cir. 1981); Mauriber v. Shearson/Am. Express, Inc., 567 F. Supp. 1231, 1240 (S.D.N.Y. 1983); Windsor Assoc., Inc. v. Greenfield, 564 F. Supp. 273, 279 (D. Md. 1983); Crocker Nat'l Bank v. Rockwell Int'l Corp., 555 F. Supp. 47, 50 (N.D. Cal. 1982); *In re* Catanella & E.F. Hutton & Co. Sec. Litig., 583 F. Supp. 1388, 1434-37 (E.D. Pa. 1984). Even the Second Circuit, which imposed a racketeering requirement in *Sedima*, 741 F.2d at 496-97, acknowledged that its position was in the minority: "although some courts have read RICO to require a showing of 'competitive' or 'racketeering' injury, more have held against imposing such limitations." *Id.* at 492-93 (footnotes omitted).

[71] *See, e.g., Haroco*, 747 F.2d at 389 ("Many district courts have imposed on RICO plaintiffs a racketeering injury requirement without explaining what the requirement is.").

[72] *Sedima*, 741 F.2d at 509 (Cardamone, J., dissenting); *see also* Bennett v. Berg, 685 F.2d 1053, 1059 (8th Cir. 1982); Hokama v. E.F. Hutton & Co., 566 F. Supp. 636, 643 (C.D. Cal. 1983) (racketeering injury requirement "little more than indirect statements" of requirement of "a 'nexus to organized crime' "); Windsor Assocs., Inc. v. Greenfield, 564 F. Supp. 273, 279 (D. Md. 1983) (racketeering injury "analytically indistinguishable" from argument that RICO applies only to organized crime).

[73] *See Sedima*, 473 U.S. at 504-06.

3. Prior Criminal Conviction

As with other attempts to limit civil RICO's scope, the question of whether RICO requires a criminal conviction of the predicate offenses produced a judicial disagreement. The Second Circuit emphasized that RICO was "designed only to penalize conduct already determined to be criminal."[74] Other opinions stated only that the statute applies to conduct that *could* be punished criminally.[75] And as with the "racketeering injury" issue, the attempt to limit RICO's reach failed as the Supreme Court in *Sedima* rejected a prior criminal conviction requirement by declaring that "racketeering activity consists not of acts for which the defendant has been convicted, but of acts for which he could be."[76] Because a prior criminal conviction is not needed, civil rules apply. This interpretation led to a preponderance of evidence burden of proof for a RICO offense. Had the Court required a criminal conviction, a beyond a reasonable doubt standard would have applied in civil RICO cases.

C. Summary

Attempts by defendants and a number of courts to limit RICO's reach have generally met with failure. After *Sedima*, plaintiffs can clearly use RICO in almost all matters involving ordinary fraud and in many commercial disputes as well. Part III of this Article discusses the implications of this liberal judicial attitude towards the statute.

III. Economic Analysis

A. Multiple Damages

The goal of fines or penalties in criminal cases is to ensure that "crime does not pay."[77] This goal is achieved by having expected penalties (whether in the form of fines or imprisonment)[78] at least equal to

---

[74] *Sedima*, 741 F.2d at 503.

[75] *Sedima*, 473 U.S. at 489. Decisions rejecting a prior criminal conviction requirement include: Bunker Ramo Corp. v. United Business Forms, Inc., 713 F.2d 1272, 1287 (7th Cir. 1983); Morosani v. First Nat'l Bank, 703 F.2d 1220 (11th Cir. 1983); USACO Coal Co. v. Carbomin Energy, Inc., 689 F.2d 94, 95 n.1 (6th Cir. 1982); Kimmel v. Peterson, 565 F. Supp. 476, 490 (E.D. Pa. 1983); Mauriber v. Shearson/Am. Express, Inc., 546 F. Supp. 391, 396 (S.D.N.Y. 1982); Hellenic Lines, Ltd. v. O'Hearn, 523 F. Supp. 244 (S.D.N.Y. 1981); Parnes v. Heinold Commodities, Inc., 487 F. Supp. 645, 647 (N.D. Ill. 1980).

[76] *Sedima*, 473 U.S. at 489.

[77] Becker, *Crime and Punishment: An Economic Approach*, 76 J. Pol. Econ. 168 (1968).

[78] *See* Block & Lind, *An Economic Analysis of Crimes Punishable by Imprisonment*,

the gains from criminal activity. Expected penalties by definition equal the probability of conviction times the penalty if convicted. There are an infinite number of ways to achieve any given level of expected penalty. All of these penalties, however, will imply the same total fine or jail term; the only distinction is the average penalty — how many malefactors will pay this price. Punishing as few criminals as possible is cheaper because substantial detection and conviction costs can be saved if fewer criminals are caught.

Because of these detection and conviction costs, it does not pay to catch and convict all criminals. In other words, the chances of catching and convicting any one criminal should be low. However, this implies that the penalty imposed on those who are convicted should be high. A low probability of conviction is consistent with, among other features, a difficult burden of proof, such as beyond a reasonable doubt.[79] This standard means (intentionally) that some guilty parties will go free. Therefore, for those who are convicted, penalties must be a multiple of gains from crime in order to ensure that crime does not pay in an expected sense. On the other hand, if the standard of proof is preponderance of the evidence, then a smaller number of guilty parties will go free; in fact, some innocent parties will be convicted. In these circumstances, there is less justification for multiplying damages.

In RICO cases, costs of detection of offenders are not high, so there are essentially no detection costs on which to economize. In normal criminal cases the justification for low probabilities of conviction is the need to save on detection costs. This need does not arise in RICO cases. After a normal crime, society is generally aware of the crime, but not the criminal's identity. Finding the criminal is expensive. This indicates that the probability of conviction should be low in order to save the costs of catching and convicting many violators. In RICO cases, on the other hand, we know the identity of the "criminal" but are uncertain as to the crime's existence. That is, RICO cases commonly arise out of normal business relationships, so the violator's identity is known. What is not known is whether the alleged act is actually a violation; that is, whether or not some transaction was "fraud." A major cost of catching criminals is in discovering the criminal's identity. This cost does not exist in RICO cases, thus indicating that low probabilities of conviction

---

4 J. LEGAL STUD. 479 (1975); Shavell, *Criminal Law and the Optimal Use of Nonmonetary Sanctions as a Deterrent*, 85 COLUM. L. REV. 1232 (1985).

[79] Keenan & Rubin, *Criminal Violations and Civil Violations*, 11 J. LEGAL STUD. 365 (1982) (demonstrating that high standard of proof, such as "beyond a reasonable doubt," is equivalent to lowered probability of conviction).

and multiplication of damages may not be justified.

Economic crimes such as fraud are essentially transfers. There is a loss to the victim but this loss is exactly offset by a gain to the perpetrator.[80] RICO cases are economic frauds, so they represent such transfers. There is no efficiency loss from transfers as such, since the amount lost is equal to the amount gained. However, there are market costs from fraud and other criminal transfers.

This market cost consists of two parts. First, potential victims spend resources to avoid becoming victimized. In the case of fraud, for example, persons engaging in transactions will spend resources examining reputations and past histories of those with whom they contemplate transacting so as to avoid being defrauded. These resources are a real cost to society of the existence of fraud. The second market cost is that some worthwhile transactions will be avoided. That is, some bargains that would potentially benefit both parties will not be made because one party or the other will be afraid of being defrauded. The forgoing of the potential gains from such transactions is also a real cost to society of the existence of fraud. The social benefit from deterring fraud (or crime in general) is the avoidance of these market costs.

In civil law, the goal of enforcement is to achieve efficient outcomes in transactions that are themselves justified, although if incentives are correct this will also lead to efficient market outcomes.[81] The results of the particular transaction are of interest in civil cases, rather than the market incentive effect. For this reason private enforcement of civil law is generally preferable since private parties have correct incentives for bringing cases. On the other hand, when the goal of enforcement is a market goal, as in criminal cases, there are reasons for preferring public enforcement.

B. Private Enforcement

Multiplied damages are efficient when only a fraction of violators are caught. With public enforcement, the same public authority determines both the penalty and the reaction of violators to be punished. This authority can achieve the social optimum simultaneously by varying both probability (determined by, for example, the police budget) and the penalty schedule. Private enforcement does not afford this re-

---

[80] R. POSNER, ECONOMIC ANALYSIS OF LAW ch. 7 (3d ed. 1986); Tullock, *The Welfare Costs of Tariffs, Monopolies, and Theft*, 5 WEST. ECON. J. 224, 224-32 (1967).

[81] *See generally* R. POSNER, *supra* note 80; *see also* Rubin, *Why is the Common Law Efficient?*, 6 J. LEGAL STUD. 51 (1977).

sult, because a public authority determines the penalty schedule while a private enforcer determines the probability of conviction.

When damages are multiplied, private enforcement will be inefficient because private enforcers with the ability to achieve fines that are a multiple of damages will have an incentive to overenforce the law.[82] That is, it is only efficient for fines to be a multiple of damages if only a fraction of violators will be caught. If enforcement is public, the enforcer simultaneously determines both the penalty and the probability.[83]

The deterrence goal of criminal cases must be distinguished from the goal of civil cases. In the latter, the goal is optimal behavior with respect to otherwise efficient transactions. For example, in contract law one goal is efficient breach: a party will only breach if the benefit exceeds the cost.[84] The benefits of private suits are largely private, although rulemaking does create a public (market) benefit.[85] In criminal cases, most of the benefit is public, rather than private. Thus, if we want to use private enforcement with a market goal, we must relate the private gains from litigation to the social gains. This linkage is not automatic; either overdeterrence or underdeterrence is possible. Our contention here is that trebling of damages in RICO cases will lead to overdeterrence.

In some situations, private enforcement leads to underenforcement, rather than overenforcement, of laws.[86] If fines are difficult to collect

---

[82] This result was first shown in Landes & Posner, *The Private Enforcement of Law*, 4 J. LEGAL STUD. 1 (1975), responding to Becker & Stigler, *Law Enforcement, Malfeasance, and Compensation of Enforcers*, 3 J. LEGAL STUD. 1 (1974). Becker and Stigler had argued for increased reliance on private enforcement. However, Landes and Posner argued that private enforcers would have an incentive to overenforce the law if public authorities set the penalties at high levels.

[83] One study has argued for retaining private enforcement, but having the state pay enforcers based on some observable outcome, rather than allowing them to collect set fines. Cohen & Rubin, *Private Enforcement of Public Policy*, 3 YALE J. REG. 167 (1985).

[84] The literature on the efficiency of contract law is extensive. For some of this literature, see the summary in A. POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 25-37, 57-65 (1983); see also Polinsky, *Risk Sharing through Breach of Contract Remedies*, 12 J. LEGAL STUD. page missing (1983); Shavell, *Damage Measures for Breach of Contract*, 11 BELL J. ECON. 466 (1980); Shavell, *The Design of Contracts and Remedies for Breach*, 99 Q. J. ECON. 121 (1984).

[85] *See* Rubin, *supra* note 81 (showing that if litigants are "correctly" chosen, private litigation can lead to socially efficient rules even though no one has any incentive to seek such rules).

[86] Polinsky, *Private versus Public Enforcement of Fines*, 9 J. LEGAL STUD. 105 (1980).

because violators have little money and if the crimes under consideration have a high social cost, then private enforcers will be likely to underenforce.[87] However, these circumstances are particularly unlikely in RICO cases. Actions covered by RICO are cases in which offenders probably have private wealth and can pay fines. Moreover, many actions covered by RICO have low social costs. Thus, overenforcement is more likely than underenforcement in RICO cases.

C. Types of Cases

The probable overenforcement in RICO cases means that society will inefficiently spend too much on enforcing this statute. However, this is not the major cost of RICO. Rather, the major cost is the overdeterrence of useful activity that civil enforcement of RICO causes.

To understand this, a distinction between conditionally and unconditionally deterred crimes needs to be made. A conditionally deterred crime is an action that should be undertaken if the benefits outweigh the cost. An example is double parking.[88] Double parking imposes a cost on other drivers that generally exceeds the benefit to a double parker. Therefore, it is generally inefficient to allow people to double park. On the other hand, sometimes double parking is efficient — for example, when one goes into a drug store in an emergency to buy life saving medicine. Therefore, a punishment can be too high and thus overdeter double parking.

In general, conditionally deterred crimes are crimes committed as part of some desirable activity. For example, the death of a patient on the operating table may be a crime (if, for example, the physician were drunk), but overdeterrence is possible because operating is generally a useful activity. Many regulatory crimes are conditionally deterred. Unconditionally deterred crimes are crimes like murder, rape, and robbery, which should never happen. It is impossible to overdeter such crimes.[89]

---

[87] *Id.*

[88] Polinsky & Shavell, *The Optimal Tradeoff Between the Probability and Magnitude of Fines*, 69 AM. ECON. REV. 880 (1979). They show that increasing penalties and reducing probabilities has a limit in that risk bearing costs become large when there is a chance for large penalties.

[89] Posner, *An Economic Theory of the Criminal Law*, 85 COLUM. L. REV. 1193, 1195 (1985) argues that such actions are examples of people avoiding the use of markets: "Market bypassing in such situations is inefficient — in the sense in which economists equate efficiency with wealth maximization — no matter how much utility it may confer on the offender" (footnote omitted).

Most or all of the activities that RICO covers are related to normal business practice, and thus are susceptible to overdeterrence. For example, "churning"[90] of a brokerage account may be a crime; yet trading in an account is a useful activity (ignoring efficient market arguments). Overdeterring churning will stop some useful trading.[91] Similarly, overdeterring advertising fraud will prevent customers from receiving useful information. Civil RICO leads to overdeterrence of useful activities. Moreover, civil RICO adds to uncertainty in at least two ways. First, the trebling of damages means that the range of damages is made three times as large: if actual damages are $X, then the possibility of loss without RICO is between $0 and $X; with RICO, it is between $0 and $3X. This increase in range causes an increase in uncertainty. Second, the addition of a cause of action increases the chances of litigation, adding further uncertainty. Such uncertainty generates even greater overdeterrence.[92]

In the next section we provide some examples of actual and potential RICO litigation and show how the actual cases relate to the theoretical costs we have identified so far.

IV. Some Examples

A. Advertising Fraud

Consider fraudulent advertising as an example. Civil RICO may be used in conjunction with, or instead of, the Federal Trade Commission to deter false or deceptive advertising. Such deterrence is likely to be inefficient; the benefits are likely to be small and the costs are likely to be large.[93]

---

[90] Churning is trading by a broker for the purpose of generating commissions rather than for the purpose of improving the position of the client. *See In re* Catanella & E.F. Hutton & Co. Sec. Litig., 583 F. Supp. 1388, 1405 (E.D. Pa. 1984).

[91] For an argument that current securities laws, without RICO, are roughly efficient, see Easterbrook & Fischel, *Optimal Damages in Securities Cases*, 52 U. Chi. L. Rev. 611 (1985). In the case of "churning," for example, Easterbrook and Fischel observe that "any commissions generated by the excessive trading must be returned to the customer. This tracks the line of optimal damages. The commissions are the bulk of the net harm in brokers' misconduct cases." *Id.* at 649 (footnote omitted).

[92] Calfee & Craswell, *Some Effects of Uncertainty on Compliance with Legal Standards*, 70 Va. L. Rev. 965 (1984). This overdeterrence occurs because the chance of litigation of fault adds an additional risk and spending resources is worthwhile to avoid being put in this position.

[93] RICO counts have not yet been added in any deceptive advertising cases. However, the current interpretation of RICO does not preclude such cases, and we may confidently expect some to arise. The closest is International Paint Co. v. Grow Group,

Consider first the benefit. If RICO can deter fraud, it is a benefit. However, this is somewhat unlikely. First, not many fraudulent advertising cases exist.[94] Fraud may not pay well, and even if it does, those skilled in fraud are probably also skilled in hiding assets. This implies that private enforcers are likely to realize a relatively small gain from catching those engaged in fraud.

Using RICO to deter fraudulent advertising also involves costs. Ambiguities in advertisement interpretations[95] may allow easy accusations of legitimate firms not engaged in fraud. Since these firms are legitimate, they would have had no incentive to hide assets. Thus, it may be more lucrative for RICO practitioners to sue legitimate firms than to sue crooked firms. In this case, legitimate firms would have a strong incentive not to provide information in advertisements because it might be construed as fraudulent and would leave them open to a suit.

B. Contractual Fraud

Many of the cases involve dealings between business firms with contractual relations.[96] Some of these cases clearly involve fraud. For example, in *Bunker Ramo Corp. v. United States Business Forms, Inc.*,[97] and in *Alcorn County v. U.S. Interstate Supplies, Inc.*,[98] the allegations were that purchasing agents were bribed to sign for undelivered sup-

---

No. 86 Civil 2131 (RLC) (S.D.N.Y. filed Oct. 22, 1986), in which a RICO claim was coupled with a Lanham Act, 15 U.S.C. § 1051 (1982), claim for failure to disclose all ingredients on a pesticide label. This complaint was dismissed, but in principle there is no reason why deceptive advertising cases cannot be brought under RICO.

[94] Posner, *The Federal Trade Commission*, 37 U. CHI. L. REV. 47 (1969), finds few worthwhile FTC cases in an extensive empirical survey. Jordan & Rubin, *An Economic Analysis of the Law of False Advertising*, 8 J. LEGAL STUD. 527 (1979) argues that on theoretical grounds there is little expectation of costly false advertising, and find few cases in which remedies are justified.

[95] Beales, Craswell & Salop, *The Efficient Regulation of Consumer Information*, 24 J. L. & ECON. 491, 491-539 (1981).

[96] *See, e.g.*, *Sedima*, 473 U.S. 479; Battlefield Builders, Inc. v. Swango, 743 F.2d 1060 (4th Cir. 1984); Furman v. Cirrito, 741 F.2d 524 (2d Cir. 1984); Alcorn County v. U.S. Interstate Supplies, Inc., 731 F.2d 1160 (5th Cir. 1984); Bunker Ramo Corp. v. United Business Forms, Inc., 713 F.2d 1272 (7th Cir. 1983); Oklahoma v. Children's Shelter, Inc., 604 F. Supp. 867 (W.D. Okla. 1985); Wang Laboratories, Inc. v. Burts, 612 F. Supp. 441 (D. Md. 1984); Windsor Assocs., Inc. v. Greenfield, 564 F. Supp. 273 (D. Md. 1983); Crocker Nat'l Bank v. Rockwell Int'l Corp., 555 F. Supp. 47 (N.D. Cal. 1982); Engl v. Berg, 511 F. Supp. 1146 (E.D. Pa. 1981).

[97] 713 F.2d 1272 (7th Cir. 1983).

[98] 731 F.2d 1160 (5th Cir. 1984).

plies. *Oklahoma v. Children's Shelter, Inc.*,[99] involves reasonably clear Medicaid fraud. Such behavior is clearly criminal, and there is no danger of overdeterrence. However, in these cases it is not clear what a RICO count adds to litigation possibilities. In *Alcorn County*, for example, the plaintiff claimed punitive damages under state law. Nonetheless, in the case of clear fraud, RICO may serve some additional deterrent purpose.

On the other hand, a party may sometimes allege fraud in cases in which there is merely a normal business dispute.[100] In *Sedima*, the facts as stated in the decisions are not sufficiently clear to determine whether fraud is involved. The issue in this case was overbilling in a joint venture agreement.[101] The possibility of RICO counts with trebled damages being used in normal business disputes, such as *Sedima* may well have been, may lead to overdeterrence of useful behavior, such as the forming of joint ventures.

Under current interpretations, almost any dispute in a contractual violations case will generate a corresponding RICO claim.[102] Such a claim allows trebling of damages. Interestingly, under the common law of punitive damages, if the contracting parties had specified treble damages, they would probably have been held illegal as punitive rather than liquidated damages.[103] RICO in effect inserts punitive damages in a context in which they have not been and cannot be contracted for.

The economic literature on punitive damages is large and inconclu-

---

[99] 604 F. Supp. 867 (W.D. Okla. 1985).

[100] *See, e.g.*, Furman v. Cirrito, 741 F.2d 524 (2d Cir. 1984) (involving whether certain partners' interests were adequately represented in connection with the sale of the partners' brokerage firm); Wang Laboratories v. Burts, 612 F. Supp. 441, 443 (D. Md. 1984) (this matter may simply have represented a dispute between a manufacturer and a distributor concerning the latter's authorized distribution area); Crocker Nat'l Bank v. Rockwell Int'l Corp., 555 F. Supp. 47 (N.D. Cal. 1982) (involving complicated financial transactions for the leasing of computers to Rockwell).

[101] Justice Powell described *Sedima* as one of those "garden variety fraud and breach of contract cases . . ." that RICO was being construed to reach. 473 U.S. at 508 (Powell, J., dissenting).

[102] The sponsor of legislation to reform RICO argued that: "Virtually every type of contract dispute has been turned into a RICO case." *Reining In RICO*, Washington Post, Oct. 14, 1986, at A13 (quoting remarks of Rep. Frederick C. Boucher (D-Va.)). In his dissenting opinion, Justice Powell complained that *Sedima* would "encourage continued expansion of resort to RICO in cases of alleged fraud or contract violation rather than to the traditional remedies in state court." *Sedima*, 473 U.S. at 521 (Powell, J., dissenting). According to one commentator: "By 1981 . . . private plaintiffs began to discover that broad interpretation of RICO would enable them to assert a civil RICO claim in nearly any fraud action." Abrams, *supra* note 18, at 1482.

[103] *See* R. POSNER, *supra* note 80, at 116.

sive.[104] Our purpose here is not to resolve the issue of contractual penalty clauses. However, allowing RICO treble damage clauses in contract enforcement cases effectively allows the aggrieved party to unilaterally impose a penalty even if the parties did not contract for such remedies. It is difficult to determine whether contractually agreed upon penalties are efficient, but if a decision is made that such clauses should be honored, then removing the common law prohibition of penalty clauses would be possible. The use of RICO in contractual disputes goes beyond this: It allows penalties even in circumstances in which the parties did not agree to them. An intermediate step — allowing but not requiring penalties — would seem preferable. Moreover, a major cost of enforcing penalty clauses may be an increase in litigation, one of the other issues relevant in the analysis of RICO.[105]

A problem in all business contracts is "opportunism."[106] Problems of opportunism in contracting are well known, and many features of real world contracts can be assumed to be aimed at reducing such behavior. However, triple damages are not used as a private remedy for opportunistic breaches. Although private contractors are continually seeking contractual mechanisms to reduce opportunism, apparently none have found a triple damage remedy to be worthwhile. This may be because such remedies would be illegal as punitive damages. If so, the solution, as mentioned above, would seem to be allowing but not requiring penalty clauses in contracts. By imposing RICO based remedies, the courts are requiring a contractual provision that otherwise would be prohibited. Again, the intermediate step of allowing but not requiring penalties would seem preferable. One alternative would be for firms to "contract out" of RICO, but because it is a criminal statute, this would be difficult or impossible.[107]

---

[104] In his book, *Economic Analysis of Law*, *id.*, Judge Posner generally argues for enforcement of such clauses, as do Goetz & Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554 (1977). Clarkson, Miller & Muris, *Liquidated Damages v. Penalties: Sense or Nonsense?*, 1978 WIS. L. REV. 351, and Rubin, *Unenforceable Contracts: Penalty Clauses and Specific Performance*, 10 J. LEGAL STUD. 237 (1981) provide arguments in favor of the legal doctrine that refuses to enforce penalty clauses. Rae, *Efficiency Implications of Penalties and Liquidated Damages*, 13 J. LEGAL STUD. 147 (1984), argues that penalty clauses should sometimes be enforced and sometimes not, depending on a complex set of circumstances.

[105] Rubin, *supra* note 81.

[106] *See generally* O. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM (1985); Klein, Crawford, & Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J. L. & ECON. 297 (1978).

[107] Contracts that violate a penal statute or require performance of a crime or tort

In many circumstances firms are faced with a choice as to whether to use complex contracting methods or vertical integration.[108] That is, firms must decide whether to contract with other firms for needed products and services, or to produce these goods and services themselves (vertically integrate), perhaps by buying other firms. This decision depends on the relative transactions costs of the alternatives. Vertical integration adds monitoring costs while complex contracting adds the possibility of costs of opportunism. That is, vertical integration requires supervision of additional employees, while contracting requires policing to avoid being defrauded. When there is a possibility of a RICO count in a contractual dispute, the cost of contracting rises relative to the cost of vertical integration, and therefore the existence of this statute may lead to more vertical integration than would otherwise be efficient. The use of less efficient (more costly) business arrangements to avoid the chance of a RICO claim would be a particularly expensive consequence of this law.

As a final note, in situations exhibiting clear criminal violations, in addition to a RICO claim, either criminal penalties or punitive damages are available under common law. However, the RICO claim would add relatively little in those cases. The easier burden of proof under RICO is likely to make a difference in determining whether a case is brought only in situations in which the facts are the least clear. In other words, a RICO claim is most likely to have an effect on litigation of a normal business contract dispute in just those situations in which it is least needed and most likely to be inefficient.

---

are generally unenforceable. *See* Gellhorn, *Contracts and Public Policy*, 35 COLUM. L. REV. 679 (1935) (noting a " 'well-settled rule' . . . that contracts will not be enforced if in violation of a penal statute . . ."). Such contracts are regarded as "illegal bargains" and are unenforceable because their performance would offend public policy. *See* RESTATEMENT (SECOND) OF CONTRACTS § 178 (1981); A. CORBIN, CONTRACTS §§ 1373-78 (1962); S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS §§ 1628-49 (3d ed. 1972). Moreover, parties to such contracts cannot waive the defense of illegality. *See id.* § 1630B.

Although a bargain to waive rights under RICO's penalty provisions is not a bargain to perform an illegal act, because the subject matter of RICO pertains to criminal conduct, any waiver of rights under the Act might be regarded as offending public policy, hence an illegal bargain.

[108] *See* O. WILLIAMSON, *supra* note 106; Klein, Crawford & Alchian, *supra* note 106, at 297-326.

C. Bankruptcy

Some RICO cases involve actions of management of firms that are in danger of going bankrupt. For example, *Federal Deposit Insurance Corp. v. Hardin*[109] involved a failing bank allegedly extending loans illegally, and *Schacht v. Brown*[110] involved an insurance company that also became insolvent. While fraud may have existed in these cases, second guessing the manager of a failing firm is generally difficult. In that situation, a manager might legitimately engage in risky behavior to stave off failure. If failure occurs anyway, it may appear that the behavior was illegal. Adding a treble damage provision and an easy burden of proof will only lead to excess prudence on the manager's part in such circumstances. The likely result is that some firms which could have avoided bankruptcy by risky investments will instead go under — an inefficient result.

D. Bank Fraud

Several cases deal with bank fraud, primarily overcharging of interest based either on contractual interest rates or on violations of the Truth in Lending Act.[111] The efficiency gains from trebling damages in such cases are dubious. The Truth in Lending Act is a complex statute, and overcharges are consistent with an intent to obey the law. In other words, under the Act it is possible for a firm to *accidentally* overcharge (or, for that matter, undercharge). In cases in which the contractual rate is tied to the prime rate, erroneous overcharges again are possible. Even if overcharges are intentional, trebling damages would serve no efficiency purpose. Normal damages in such cases would provide incentives for borrowers to optimally check interest charges for error. Trebling damages would encourage borrowers and lenders to spend substantially more resources in monitoring interest charges (lenders to avoid RICO convictions, borrowers to find them) with no other efficiency implications.

---

[109] 608 F. Supp. 348 (E.D. Tenn. 1985).

[110] 711 F.2d 1343 (7th Cir. 1983).

[111] 15 U.S.C. § 1601 (1982). Such cases include: Haroco, Inc. v. American Nat'l Bank & Trust Co., 747 F.2d 384 (7th Cir. 1984), *aff'd*, 473 U.S. 606 (1985); Morosani v. First Nat'l Bank, 703 F.2d 1220 (11th Cir. 1983); and Bays v. Hunter Savs. Ass'n, 539 F. Supp. 1020 (S.D. Ohio 1982).

E. Securities Fraud

Many RICO cases involve securities fraud. One common type of case is "churning" — trading aimed at maximizing the broker's commission.[112] The main issue in such cases is overdeterrence. Most trading is efficient, but when chances for treble damages exist, some brokers will be overly cautious and unwilling to engage in even efficient trades. This creates substantial efficiency costs.[113] Penalties for violations of securities laws without trebling or other forms of punitive damages are close to efficient. To the extent that this is true, any increase in penalties will probably have counterproductive effects; the major cost will be overdeterring otherwise efficient behavior.

V. Summary and Policy Implications

The civil provisions of the RICO statute impose costs and provide benefits. This summary will discuss first the costs, then the benefits of the law, and finally modifications in the law that would increase the statute's net benefits.

The RICO statute imposes two types of costs. First, there are simple enforcement costs. For the sort of criminal harms encompassed by RICO, the efficient pattern of enforcement is a low probability of conviction coupled with a high penalty. However, with private enforcement, the expectation is for both high penalties and high levels of enforcement, since the high penalties will induce private parties to spend more resources on enforcement than is optimal. The result is waste, as too many resources are spent on enforcement.[114]

Probably the major cost of civil RICO is the efficient behavior deterred, rather than overspending on enforcement. Many of the activities to which courts have applied civil RICO are "conditionally deterred" activities; that is, they are activities that may serve some useful purpose and that can be overdeterred if penalties are too draconian.[115] Some of these activities are: providing useful information in advertising; dealing with other firms in, *e.g.*, joint ventures; engaging in risky behavior to

---

[112] Examples include: *In re* Catanella & E.F. Hutton & Co. Sec. Litig., 583 F. Supp. 1388 (E.D. Pa. 1984); Taylor v. Bear Stearns & Co., 572 F. Supp. 667 (N.D. Ga. 1983); Harper v. New Japan Sec. Int'l, Inc., 545 F. Supp. 1002 (C.D. Cal. 1982); Landmark Savs. & Loan v. Rhoades, 527 F. Supp. 206 (E.D. Mich. 1981).

[113] For a general discussion of penalties in securities laws, see Easterbrook & Fischel, *supra* note 91. Their argument is based on the modern economic theory of efficient financial markets and the theory of optimal sanctions, similar to that used here.

[114] *See supra* notes 77-81 and accompanying text.

[115] *See supra* notes 88-92 and accompanying text.

attempt to avoid bankruptcy; and trading in stock market accounts by brokers. Moreover, many of the provisions of RICO have only recently emerged from litigation and court interpretations, leading us to predict that many other types of disputes will become RICO disputes as litigants adapt to the statute. In fact, it seems likely that most disputes between businesses will be cast as RICO disputes, since there are few bars to such counts and since the benefits (treble damages and attorneys fees) are substantial.

As the possible penalties for potentially useful activities increase, we may expect inefficient adaptations. Some useful information (which might be interpreted as being deceptive) will not be provided in advertising; some useful business contracts will not be signed and some productive joint ventures will be avoided. Some firms will use vertical integration rather than contracting with other firms; some unnecessary bankruptcies will occur; and some useful stock trades will not occur. Again, it is the overdeterrence of these useful activities that is likely to be the major cost of civil RICO.

The benefits of RICO as now drafted relate to its deterrence of some criminal activity. As we have seen, some of the cases[116] involved fraud, and there no doubt have been and will continue to be other cases where fraud will be deterred. However, as we have also seen, this gain is purchased at a substantial cost in terms of inefficiently deterred activities.[117] It is therefore natural to ask if there is some less costly way to achieve the same goal.

One possibility that has been mentioned several times is to relax the common law prohibition of penalty clauses in contracts. The economics literature is ambiguous as to whether such a relaxation would be beneficial; there may be some benefits from the prohibition. Nonetheless, what RICO does is not only to eliminate the prohibition on contractually agreed upon penalties, but to go beyond and actually force parties to accept punitive (multiplied) damages. An intermediate position — allowing but not requiring penalty clauses if parties agree — would surely be preferable.

Second, the statute could be modified in various ways. One possible modification that Congress debated but did not pass was that civil damages would be available only if the defendant had previously been convicted of a criminal RICO violation.[118] This would have the effect of making the burden of proof "beyond a reasonable doubt," rather than

---

[116] *See, e.g.*, cases cited *supra* notes 97-99.

[117] *See supra* notes 88-92 and accompanying text.

[118] *See Reining in RICO*, Washington Post, Oct. 14, 1986, at A13.

"preponderance of the evidence." Such a modification would reduce the probability of conviction and would therefore reduce the overdeterrence of useful activities.

Another possibility is to eliminate treble damages. This would reduce the incentive for bringing private litigation and would therefore also reduce the statute's overdeterrence. In fact, eliminating this provision would essentially remove the statute, since everything covered by RICO would be covered as well by normal civil damage remedies, and the only benefit of RICO is the increase in damages.

This might not be a bad thing. The economic theory of enforcement indicates that a public authority should determine simultaneously both the probability of conviction and the fine if convicted. However, the existence of private treble damages means that public prosecutors cannot control penalties,[119] since the successful prosecution of a public RICO case would lead to a number of private treble damage civil suits as well. Moreover, criminal prosecutors have a wide latitude in determining both probabilities and magnitudes of penalties,[120] so that it should be possible for public prosecutors to achieve optimal deterrence. That is, public prosecutors can vary probabilities of conviction and severity of punishment so as to achieve whatever level of deterrence is desired. It is not clear that adding private treble damage remedies adds to the goal of achieving optimal deterrence.

---

[119] This is a major complaint brought up by Justice Marshall in his *Sedima* dissent. *See Sedima*, 473 U.S. at 527 (Marshall, J., dissenting); *supra* note 34.

[120] Easterbrook, *Criminal Procedure as a Market System*, 12 J. LEGAL STUD. 289 (1983).