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Pleading Civil RICO: Lessons From The Abbott Litigation

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On Jan. 4, 2017, U.S. District Judge Carol Bagley Amon of the Eastern District of New York issued a memorandum and order dismissing civil Racketeer Influenced and Corrupt Organizations Act claims, including RICO conspiracy, and unjust enrichment claims in a massive, single case brought by Abbott Laboratories against 300 wholesale distributors and independent pharmacies dealing in its blood glucose test strips. (Abbott Laboratories et al. v. Adelphia Supply USA et. al., 15-CV-5826).


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The dismissal of the RICO and unjust enrichment claims not only eliminated Abbott's potential for treble damages in the case, but serves as a strong reminder for complex civil litigation practitioners that civil RICO claims must meet special pleading requirements, especially where the plaintiff alleges large, complicated schemes. Moreover, importantly for the civil practitioner, alleging RICO requires substantially more than pleading garden-variety fraud, which, itself, requires particularized descriptions of the fraudulent conduct. While Abbott's trade infringement and fraud claims are ongoing in the case, the court, in its 31-page decision dismissing the RICO and unjust enrichment claims, emphasized that in the civil context, courts strive to flush out frivolous RICO allegations at an early stage. The mere assertion of a RICO claim has an almost inevitable stigmatizing effect on those named as defendants.

The gravamen of Abbott's complaint is that the wholesale distributor defendants — in excess of 180 of them — infringed on its trademark by importing and selling Abbott's FreeStyle blood glucose test strips intended to be sold in its international market channels into the domestic marketplace. Abbott alleged that the wholesalers conspired with pharmacy defendants — all 120 of them — to effect fraud on insurers and Abbott by processing the related insurance reimbursements for the international strips "as if" they were domestic strips; international strips are not eligible for insurance reimbursement in the United States. Although chemically identical to the domestic strips, the U.S. Food and Drug Administration does not currently permit Abbott to sell the international strips in the United States.

Essential Elements to Allege Civil RICO

To plead civil RICO, a plaintiff must allege (a) a substantive RICO violation under 18 USC §1962; (b) an injury to the plaintiff's business or property; and (c) that such injury was by reason of the substantive RICO violation. Satisfying the first prong means that the plaintiff must allege that a person engaged in (1) conduct; (2) of an enterprise; (3) through a pattern (4) of a racketeering activity. In the Abbott, despite a second amended complaint, the court found that the plaintiff failed to state a civil RICO claim because, inter alia, it failed to allege facts showing an enterprise existed and that any defendant engaged in the

conduct of such an enterprise.[1]

The RICO Enterprise

A RICO 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. In Abbott, the plaintiff argued that the over 300 defendants formed an "association in fact" enterprise, or, in other words, a unit that functioned with a common purpose. But, the law requires that, at minimum, such an association must have at least three structural features: a purpose, relationships among those associated with the enterprise, and longevity sufficient to permit these associates to pursue the enterprise's purpose.[2]

As the court ruled in Abbott, without factual allegations showing that these defendants had interpersonal relationships in which they worked together for a common illicit interest, the pleadings will constitute nothing more than a conclusory naming of a string of entities combined with legal conclusions. In other words, as shown in Abbott, all 300 defendants can demonstrate the same conduct; however, unless the pleadings demonstrate, at minimum, that the activity is coordinated there is no "enterprise." As the U.S. Supreme Court explained in Boyle, the fact that several individuals independently and without coordination engage in a pattern of crimes listed as RICO predicates is not enough to show that the individuals were members of an enterprise.[3]

In fact, key cases within the Second Circuit, including those predating Boyle, that uphold RICO allegations on the basis of the pleadings do so because the pleadings are detailed and specific about the coordination of the defendants. The pleadings in In re Sumitomo Copper Litigation,[4] for example, discuss precisely and clearly that, for example, defendants opened joint accounts in the name of one of the defendants; that the other defendants had power of attorney over the account; and that one of the defendants used the other's credit line to make purchases — all as part of the concerted effort to effect illicit activity.

Similarly, in Muscletech Research & Dev. Inc. v. E. Coast Ingredients LLC,[5] the court relies on detail of the coordination among defendants to uphold the RICO claim and to conclude that the wire and mail fraud predicate acts were in furtherance of a well-articulated master plan to defraud: defendant A mailed checks from Ontario, Canada to defendant B in New York, the proceeds of which were used to pay for the transportation of counterfeit products. Purchase orders for counterfeit product were sent by fax to defendant C to other defendants on the east coast, and, in turn, from defendant C to defendant D; then from defendant E to the other East Coast defendants. The plaintiffs also described an order for the counterfeit product placed on a date certain by plaintiffs' private investigator through an internet website maintained by defendant E. On a date certain defendant E caused the counterfeit product to be shipped from its warehouse in Connecticut to the investigator's address in North Carolina. The pleadings demonstrated how these defendants worked together; who were, in effect, the managers; and who functioned as the "worker bees."

In contrast, the Abbott pleadings, with respect to the wholesaler defendants as a whole or individually, provided no description of the defendants' specific level of coordination on any particular moment in time with the pharmacy defendants nor how their use of the mails or wires related to points in which the alleged conduct occurred.

Conducting the RICO Enterprise

A plaintiff must allege not only existence of an enterprise but the defendant's role in the enterprise. In Abbott, the court found that the plaintiff failed to establish this element because the pleadings did not distinguish where the defendants' managed their own affairs and acted in their own interests, on the one hand, versus where they played roles within a single, coordinated activity, on the other hand.[6] Abbott's central allegation for the RICO claim was that the wholesaler defendants worked in conjunction with pharmacy defendants to defraud insurers and Abbott by submitting reimbursement claims for international test strips as if they were domestic strips. However, the court pointed out that the distributors merely providing the international test strips to the pharmacies is insufficient without further alleging specifically how the distributors participated in the operation or management of the enterprise itself. Simply, courts in the Second Circuit look to the hierarchy, organization and activities of the association to determine whether its members functioned as a unit.[7] Although the Supreme Court's holding in Boyle establishes that a RICO enterprise need not have a formal hierarchy, a plaintiff must allege some structural features.[8] Otherwise, any two thieves in cahoots would constitute an association in fact.[9] As Abbott demonstrates, the lack of such detail can be fatal to a plaintiff's RICO claim.

Application of the FCRP to Pleading Civil RICO

Pleading RICO, apart from the underlying fraud, is properly measured under the liberal pleading requirements of Federal Rule of Civil Procedure 8(a) that, in sum and substance, demands only a "short and plain statement of the claim showing that the pleader is entitled to relief." However, when the RICO claims are based on predicate acts of mail and wire fraud, as in Abbott, the allegations of the underlying fraud are subject to the heightened pleading standards of FRCP 9(b).

Rule 9(b) requires, at minimum, especially in cases involving broad, multidefendant conspiracies, that the pleading as to each defendant specify the statement claimed to be false or misleading, give particulars regarding why the statement was fraudulent, state when and where the statement was made, and identify those responsible for the statement.[10] The heightened pleading requirement is applicable regardless of whether the defendants are purported to be the primary actors or aiders and abettors.[11]

In Abbott, the plaintiff argued that the complaint was not subject to Rule 9(b) because it provided a detailed description of the underlying scheme and its connection with the mail and/or wire communications and showed that the mails or wires were only used in furtherance of a scheme to defraud. However, this argument failed because, as courts in the Second Circuit have held, the relaxation of Rule 9(b)'s heightened pleading requirement is limited to those cases where the mail or wires were used solely in furtherance of a scheme to defraud.

Where the plaintiff claims that the mail or wire transmissions were themselves fraudulent, i.e., contained false or misleading information, then the mail and wire fraud claims must comply with Rule 9(b).[12] In Abbott, the complaint was replete with allegations that the mail and wire transmissions were themselves fraudulent because the defendants were alleged to have sought reimbursement for sales of test strips through transmitted written misrepresentations containing false information. The false submissions were the heart of Abbott's theory underlying the alleged scheme to defraud and constituted the predicate acts for mail or wire fraud. Nevertheless, the complaint failed to specify as to each defendant the two specific predicate acts they either themselves committed or aided and abetted another in the conspiracy to commit in furtherance of the alleged scheme to defraud. This requirement

exists because the focus of Section 1962(c) is on the individual patterns of racketeering engaged in by a defendant, rather than collective activities of the enterprise.[13]

Conclusion

Civil RICO claims are meaningfully distinct from ordinary fraud claims. The elements required to establish a RICO allegation, even at the pleading stage, likely requires an upfront investigation that surpasses in scope the level of investigation in support of ordinary fraud allegations. In many instances, therefore, where there is a preliminary view that RICO can be established, a practitioner might be well served to amend or seek amendment of the complaint following initial phases of discovery. This approach, in turn, is also cost effective for the client because briefing and arguing RICO allegations is time-consuming and requires extensive explication of law and facts. Further, where the RICO allegations are "half-baked," the practitioner might be exposed to Rule 11 sanctions.

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DISCLOSURE: Gottlieb & Janey represents wholesaler defendants in the Abbott Laboratories et al. v. Adelphia Supply USA et. al., 15-CV-5826.

[1] Decision & Order, 4.

[2] Decision & Order, 6, citing Boyle v. United States, 556 U.S. 938, 946 (2009).

[3] Decision & Order, 9, citing Boyle, 556 US at 947 n.4

[4] In re Sumitomo Copper Litig., 995 F.Supp. 451 (SDNY 1998)

[5] Muscletech Research & Dev., Inc. v. E. Coast Ingredients, LLC, No. 00-CV-0753A(F), 2004 WL 941815 (W.D.N.Y. March 25, 2004)

[6] Decision & Order, 15

[7] Foster v. 2001 Real Estate, 2015 U.S. Dist. LEXIS 159489, *9-10 (SDNY Nov. 24, 2015) (quoting Conte v. Newsday, Inc., 703 F. Supp. 2d 126, 133-34 (EDNY 2010)

[8] Id. at *12.

[9] Id.

[10] Moore v. PaineWebber, Inc., 189 F.3d 165, 173 (2d Cir. 1999); Tymoshenko v. Firtash, 2015 WL 5505841 at *4 (S.D.N.Y. Sept. 18, 2015).

[11] Krys v. Pigott, 749 F.3d 117, 129 (2d Cir. 2014).

[12] Turner v. New York Rosbruch/Harnick, 84 F.Supp. 3d 161, 168 (EDNY 2015).

[13] U.S. v. Persico, 832 F.2d 705, 714 (2d Cir. 1987)
