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# Application of Respondeat Superior Principles to Securities Fraud Claims under the Racketeer Influenced and Corrupt Organizations Act (RICO)

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## ARTICLES

# APPLICATION OF RESPONDEAT SUPERIOR PRINCIPLES TO SECURITIES FRAUD CLAIMS UNDER THE RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT (RICO)

Barbara Black\*

## I. INTRODUCTION

The Racketeer Influenced and Corrupt Organizations Act (RICO)<sup>1</sup> was enacted in 1970 as part of an overall congressional effort to combat organized crime.<sup>2</sup> The statutory language, however, lends itself to applications beyond the Act's primary purpose and can encompass ordinary commercial and business fraud claims. Plaintiffs alleging securities fraud violations under section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act")<sup>3</sup> and its rule 10b-5<sup>4</sup> now routinely add claims alleging RICO violations. Because a plaintiff who establishes injury resulting from a RICO violation can recover treble damages, the settlement value of his claims is significantly enhanced.<sup>5</sup> As this aspect of RICO has become more widely

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1. 18 U.S.C. §§ 1961-68 (1982), *amended by* Comprehensive Crime Control Act of 1984, Pub. L. No. 98-473, § 1020, 98 Stat. 2143.

2. RICO was enacted as Title IX of the Organized Crime Control Act of 1970, Pub. L. No. 91-452, 84 Stat. 941 (1970).

3. 15 U.S.C. § 78j(b) (1982).

4. 17 C.F.R. § 240.10b-5 (1984).

5. In recent years there has been "an explosion of civil RICO litigation," *Sedima, S.P.R.L. v. Imrex Co.*, 741 F.2d 482, 486 (2d Cir. 1984), *rev'd*, 53 U.S.L.W. 5034 (1985). While there were only a few cases including civil RICO claims in the first 10 years of the statute's existence, there are now over 100 published decisions. *Id.* Apparently, few cases have gone to trial; almost all of the reported decisions involve issues raised in the pre-trial stages. There is, however, at least one decision awarding judgment for the plaintiff, *Fireman's Fund Ins. Co. v. Plaza Oldsmobile Ltd.*, No. 83-2213 (E.D.N.Y. June 14, 1984), 191 N.Y.L.J. June 22, 1984, at 1, col. 2. *But see id.* (E.D.N.Y. Jan. 18, 1985) (avail. on Westlaw) (court

known, securities firms and their attorneys, among others, have mounted efforts to amend the statute in order to restrict its application.<sup>6</sup>

An issue that has received little discussion in cases or commentaries is whether a plaintiff can use common law principles of vicarious liability to increase the number of possible defendants in a RICO suit. Actions alleging the "garden variety" securities frauds of churning and suitability are illustrative.<sup>7</sup> A defrauded customer may,

dismisses RICO claims as to another defendant because there was no distinct RICO injury); see also note 26 *infra*.

6. The Vice Presidential Task Group on Regulation of Financial Services has recommended that RICO be amended to make it inapplicable to securities firms, insurance companies, banks and other legitimate businesses. *Bush Task Group Endorses Amendments to RICO and ICA to Reduce Litigation*, 16 SEC. REG. & L. REP. (BNA) No. 20, at 865 (May 18, 1984). Seventy-four percent of the attorneys responding to an American Bar Association questionnaire said that RICO should be amended, and the most commonly suggested change would limit the treble damages award to victims of traditional organized and white collar crime. *RICO Task Force Reports at ABA Section Meeting, Results of Survey Presented*, 16 SEC. REG. & L. REP. (BNA) No. 15, at 638 (April 13, 1984). The Interest Rate Regulation Subcommittee of the Committee on Consumer Financial Service has established a group to propose amendments to limit RICO's use in commercial litigation. *RICO's Reported Demise, Tender Offers, ULOE Adoption Considered at Bar Meeting*, 16 SEC. REG. & L. REP. (BNA) No. 33, at 1393 (Aug. 17, 1984). The American Institute of Certified Public Accountants has formed a RICO policy task force to consider amendment limiting accountants' civil liability. 17 SEC. REG. & L. REP. (BNA) No. 2, at 57 (Jan. 11, 1985).

7. "Churning" is defined as:

any act of any broker . . . or dealer designed to effect with or for any customer's account in respect to which such broker . . . or dealer or his agent or employee is vested with any discretionary power any transactions of purchase or sale which are excessive in size or frequency in view of the financial resources and character of such account.

17 C.F.R. § 240.15c1-7(a) (1984).

The SEC takes the position that churning can take place not only in accounts where the broker-dealer technically has discretionary power but also "whenever the broker or dealer is in a position to determine the volume and frequency of transactions by reason of the customer's willingness to follow the suggestions of the broker or dealer and he abuses the customer's confidence by overtrading." *Norris & Hirshberg, Inc. v. SEC*, 21 S.E.C. 865, 890 (1946), *aff'd* *Norris & Hirshberg, Inc. v. SEC*, 177 F.2d 228 (D.D.C. 1949). The defrauded customer has a private cause of action under § 10(b) of the Exchange Act and Rule 10b-5, e.g., *Hecht v. Harris, Upham & Co.*, 430 F.2d 1202 (9th Cir. 1970).

The National Association of Securities Dealers Rules of Fair Practice state that a broker-dealer, in making recommendations to a customer, must have "reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs." Nat'l Ass'n. of Sec. Dealers, NASD Manual Art. III, § 2, ¶2152 (1979). The New York Stock Exchange's "Know Thy Customer Rule" requires a broker to "use due diligence to learn the essential facts relative to every customer." NYSE Rule 405 (CCH) New York Stock Exchange Manual ¶ 2405. It is unclear whether a customer has a private cause of action under the suitability rules, but suitability is usually an aspect of a churning case. R. JENNINGS & H. MARSH, *SECURITIES REGULATION* 571 (5th ed. 1982).

under many courts' interpretation of the statute, state a RICO claim against the registered representative who engages in such illegal practices,<sup>8</sup> but he will want to join as a defendant the securities firm employing the registered representative. It is uncertain, however, whether the employer can be held liable under RICO without a showing that it participated in its employee's frauds. Other examples are provided by RICO suits against employers based upon employees' insider trading violations<sup>9</sup> or violations of the tender offer laws.<sup>10</sup>

Part I of this article outlines RICO's statutory scheme, reviews the common law doctrines under which a principal may be liable for the acts of its agent and the policies behind these doctrines, and examines RICO decisions raising the issue of vicarious liability. Part II examines non-RICO federal cases and identifies relevant factors determining the appropriateness of applying respondeat superior and agency principles to federal statutes. Finally, Part III analyzes the specific provisions of RICO in light of the factors identified in Part II. The article concludes that these factors do not support the imposition of liability on defendants other than the primary RICO violator. Accordingly, RICO should not be extended to reach defendants liable only by reason of principles of vicarious liability. If courts refuse to extend such liability, there will be a significant reduction in the number of RICO suits brought against securities firms. As a result, the concern over the firms' potential extended liability under RICO can be alleviated without congressional amendment.<sup>11</sup>

## II. BACKGROUND

### A. *The Statutory Scheme*

RICO makes it illegal to engage in a pattern of racketeering activity to achieve certain enumerated results. A "pattern of racketeering activity" consists of at least two acts of racketeering activity within a ten-year period.<sup>12</sup> The key term, "racketeering activity," is

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8. See *infra* note 54 and accompanying text.

9. *E.g.*, *Moss v. Morgan Stanley Inc.*, 553 F. Supp. 1347 (S.D.N.Y.), *aff'd on other grounds*, 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 1280 (1984).

10. *E.g.*, *In re Action Industries Tender Offer*, 572 F. Supp. 846 (E.D. Va. 1983); *Hanna Mining Co. v. Norcen Energy Resources Ltd.*, 574 F. Supp. 1172 (N.D. Ohio 1982); *Spencer Companies, Inc. v. Agency Rent-A-Car, Inc.* [1981-82 Transfer Binder] *FED. SEC. L. REP. (CCH)* ¶ 98,361 (D. Mass. Nov. 17, 1981).

11. There are reports that Congress will consider amending RICO to limit its civil liability provisions. 17 *SEC. REC. & L. REP. (BNA)* No. 2, at 49 (Jan. 11, 1985). Senate Judiciary Committee Chairman Strom Thurmond has promised to hold hearings early in 1985. *Id.* at 57. See also *supra* note 6.

12. One of the acts of racketeering activity must have occurred after the effective date of

defined in terms of a number of state and federal offenses.<sup>13</sup> Plaintiffs in securities fraud cases rely on three of these: "any offense involving fraud in the sale of securities, punishable under any law of the United States" (section 1961(1)(D));<sup>14</sup> any act indictable under the mail fraud statute (section 1961(1)(B));<sup>15</sup> and any act indictable under the wire fraud statute (also section 1961(1)(B)).<sup>16</sup>

The inclusion of the offense of "fraud in the sale of securities" is curious. Unlike most of the enumerated federal offenses in section 1961(1), this offense refers to no specific provision in the United States Code. Section 1961(1)(D) was a late addition to the bill.<sup>17</sup> The only references to securities transactions during the Congressional hearings were to sales of forged and stolen securities by individuals associated with organized crime.<sup>18</sup> Some commentators have argued that Congress did not intend to incorporate the federal securities law into RICO.<sup>19</sup> Courts, however, have not adopted this interpretation.<sup>20</sup> The phrase "fraud in the sale of securities" is generally assumed to mean those securities violations which require a specific showing of fraud or scienter, the most common being violations of section 10(b) of the Exchange Act and its Rule 10b-5.<sup>21</sup> Additional confusion is created by the fact that, unlike section 10(b) and Rule

the statute and the last act must have occurred within 10 years (excluding any period of imprisonment) after the commission of a prior act. 18 U.S.C. § 1961(5) (1982).

13. 18 U.S.C. § 1961(1) (1982), *amended by* Comprehensive Crime Control Act of 1984, Pub. L. No. 98-473, § 1020, 98 Stat. 2143.

14. 18 U.S.C. § 1961(1)(D) (1982).

15. 18 U.S.C. § 1961(1)(B) (1982).

16. *Id.*

17. Bridges, *Private RICO Litigation Based Upon "Fraud in the Sale of Securities,"* 18 GA. L. REV. 43, 58-59 (1983).

18. *Id.* at 59, n.103.

19. *Id.* at 63; *see generally* Note, *RICO and Securities Fraud: A Workable Limitation*, 83 COLUM. L. REV. 1513, 1534-43 (1983).

20. *See infra* note 22 and accompanying text.

21. MacIntosh, *Racketeer Influenced and Corrupt Organizations Act: Powerful New Tool of the Defrauded Securities Plaintiff*, 31 U. KAN. L. REV. 7, 30 (1982); Long, *Treble Damages for Violations of the Federal Securities Laws: A Suggested Analysis and Application of the RICO Civil Cause of Action*, 85 DICK. L. REV. 201, 226 (1981). Other possible securities violations includable under § 1961(1)(D) are the other antifraud provisions of the Exchange Act, §§ 15(c) and 14(e), and of the Securities Act of 1933, § 17(a), as well as other substantive provisions which may encompass fraud, such as § 5 of the Securities Act and §§ 9 and 13(d) of the Exchange Act. One commentator concludes that "any violation of the federal securities laws other than the reporting or so-called housekeeping measures should suffice." *Id.* In *Moss v. Morgan Stanley Inc.*, 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 1280 (1984), the court held that § 1961(1)(D) excludes securities violations under Rule 10b-5 based on trading on inside information where the RICO plaintiff is a shareholder and the defendant is an outsider since, under *Chiarella v. United States*, 445 U.S. 222 (1980), defendant's conduct is not fraudulent as to the plaintiff.

10b-5, which prohibit fraud in connection with the purchase and sale of securities, section 1961(1)(D) only includes fraudulent sales. The few cases that have considered this inconsistency have concluded that the provision should be read to include fraudulent purchases as well.<sup>22</sup>

Commission of two acts of racketeering activity, or two predicate offenses within the requisite time period does not, by itself, establish a RICO violation. The illegal acts must have been committed for a specific improper purpose. There are three such prohibited purposes set forth in section 1962.<sup>23</sup> RICO securities fraud plaintiffs invariably use section 1962(c), which makes it illegal "for any person employed by or associated with any enterprise engaged in . . . interstate . . . commerce, to conduct or participate . . . in the conduct of such enterprise's affairs through a pattern of racketeering activity . . . ."<sup>24</sup> Thus, the primary RICO violator is an employee or an associate of another individual or entity; the statute is silent as to the enterprise's liability.

Finally, section 1964(c) establishes the civil remedy, providing that any person injured in his business or property by reason of a violation of section 1962 may recover treble damages and attorney's fees.<sup>25</sup> This is the reason plaintiffs strive to assert a RICO claim instead of being content with a securities fraud claim.

Prior to the Supreme Court decision in *Sedima*, the cases were split on whether to give special emphasis to the phrase "*by reason of*" a section 1962 violation. Some courts interpreted this language to mean that the plaintiff must suffer a special RICO injury to have standing.<sup>26</sup> Under this view, a RICO claim brought by a plaintiff

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22. The cases can find no basis for including sales and excluding purchases; moreover any fraudulent purchase involves a sale induced by fraud. *Hanna Mining Co. v. Norcen Energy Resources Ltd.*, 574 F. Supp. 1172 (N.D. Ohio 1982); *Spencer Companies, Inc. v. Agency Rent-A-Car, Inc.* [1981-82 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,361 (D. Mass, Nov. 17, 1981).

23. In addition, 18 U.S.C. § 1962(d) (1982) prohibits conspiring to violate subsections (a), (b) or (c) of § 1962.

24. 18 U.S.C. § 1962(c) (1982). Subsections (a) and (b) of § 1962 reflect congressional concern about the infiltration of legitimate enterprises by organized crime elements. *See infra* note 173 and accompanying text. Subsection (a) prohibits the investment of income derived from a pattern of racketeering activity into the acquisition or operation of any enterprise engaged in interstate commerce; subsection (b) prohibits the acquisition or maintenance of any interest in or control of any enterprise which is engaged in interstate commerce, through a pattern of racketeering activity.

25. 18 U.S.C. § 1964(c) (1982).

26. In *Sedima, S.P.R.L. v. Imrex Co.*, 741 F.2d 482 (2d Cir. 1984), *rev'd*, 53 U.S.L.W. 5034 (1985), the Second Circuit held that the "*by reason of*" language requires that plaintiff allege injury caused by an activity which RICO was designed to deter, which is different from

alleging securities fraud violations as the predicate offenses is inevitably dismissed, because the only alleged injuries flow directly from those violations.<sup>27</sup> Other courts, while recognizing that the RICO injury and the securities fraud injury are the same and that RICO thus serves only to increase the recovery threefold, nevertheless conclude that treble recovery is the plain intent of the statute.<sup>28</sup>

### B. *A Principal's Liability for an Agent's Acts*

A principal may be liable for an agent's torts under fault or no-

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that caused simply by the predicate acts. *Id.* at 494. In addition, the Second Circuit held that prior convictions for the predicate offenses are required to maintain a civil action. *See infra* note 53. In *Bankers Trust Co. v. Rhoades*, 741 F.2d 511 (2d Cir. 1984), the Second Circuit reiterated the requirement of a "distinct RICO injury" and provided examples where, in its view, the injury could be attributable to a pattern of racketeering activity and not just to the individual predicate acts. *Id.* at 512. This is the only opinion even hypothetically illustrating a distinct RICO injury. Judge Cardamone vigorously dissented in both these opinions. Subsequently, the Second Circuit in *Furman v. Cirrito*, 741 F.2d 524 (2d Cir. 1984), while compelled to follow *Sedima* and *Bankers Trust*, reaffirmed Judge Cardamone's views. The Second Circuit refused en banc consideration of the three cases, *Furman* at 525.

The Seventh Circuit, in *Haroco, Inc. v. American National Bank & Trust Co. of Chicago*, 747 F.2d 384 (7th Cir. 1984), *aff'd*, 53 U.S.L.W. 5067 (1985), disagreed with the Second Circuit and held that plaintiff need not allege an injury beyond any injury to business or property resulting from the underlying acts of racketeering.

In *Sedima*, the Supreme Court rejected in a 5-4 decision, the Second Circuit's requirement of a racketeering injury as without support in the language and legislative history of the Act, 741 F.2d 482 (2d Cir. 1984), *rev'd*, 53 U.S.L.W. 5034 (1985). It also rejected the Second Circuit's prior conviction requirement. In a per curiam opinion, *Harco, Inc. v. American Nat'l Bank & Trust Co. of Chicago*, 747 F.2d 384 (7th Cir. 1984), *aff'd*, 53 U.S.L.W. 5067 (1985), the Supreme Court affirmed the Seventh Circuit decision as consistent with its opinion in *Sedima*.

Other courts have held that section 1964(c) requires that plaintiff establish a "competitive" injury, reasoning by analogy from antitrust law, *Harper v. New Japan Securities International, Inc.*, 545 F. Supp. 1002, 1007 (C.D. Cal. 1982), *North Barrington Development, Inc. v. Fanslow*, 547 F. Supp. 207 (N.D. Ill. 1980); or a "racketeering enterprise" injury, reasoning by analogy from subsections (a) and (b) of section 1962, *Landmark Savings & Loan v. Loeb Rhoades, Hornblower & Co.*, 527 F. Supp. 206, 208-09 (E.D. Mich. 1981).

A third approach is found in *Lopez v. Dean Witter Reynolds, Inc.*, [1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,634 (N.D. Cal. 1984), where the court held that plaintiffs must allege either that they suffered an "enterprise injury;" or where the injury flows from the predicate acts, that the "enterprise" is organized solely for criminal purposes. None of these judicial attempts to restrict the private action can survive the Supreme Court decisions in *Sedima* and *Harco*.

27. *See supra* note 26.

28. *Wilcox v. Ho-Wing Sit*, No. C-84-0615-WWS, slip op. at 17-18 (N.D. Cal. May 3, 1984), *Ralston v. Capper*, 569 F. Supp. 1575, 1581 (E.D. Mich. 1983), *Mauriber v. Shearson/American Express, Inc.*, 567 F. Supp. 1231, 1239-40 (S.D.N.Y. 1983), *Seville Industrial Machinery Corp. v. Southmost Machinery Corp.*, 567 F. Supp. 1146, 1156-58 (D.N.J. 1983), *Eisenberg v. Gagnon*, 564 F. Supp. 1347, 1351 (E.D. Pa. 1983), *Windsor Associates, Inc. v. Greenfield*, 564 F. Supp. 273, 276-77 (D. Md. 1983).

fault theories.<sup>29</sup> A principal is liable if it is deemed a participant, along with its agent, in a fraudulent scheme. This requires, at least knowing participation in the fraud, and perhaps intentional participation.<sup>30</sup> In addition, a principal may be liable for its agents' misdeeds if it has been negligent or reckless in their selection or supervision.<sup>31</sup> These are "fault" theories of liability.

The no-fault theories of liability, on the other hand, eliminate the plaintiff's need to establish that the principal engaged in blameworthy conduct, and thus provide the plaintiff with better access to a "deep pocket." A principal may be liable to a third party injured by its agent's tort, even though the principal has not violated any duty owed to the third party and has not authorized the agent's conduct.<sup>32</sup> The basis for a firm's "no-fault" liability would be the common law agency doctrines of respondeat superior, apparent authority or a principal's liability for its agent's misrepresentations.

### 1. *Respondeat Superior*<sup>33</sup>

In general, an employer is liable for any tort, whether negligent or intentional, committed by its employee, so long as his conduct was within the scope of the employment.<sup>34</sup> Liability extends to frauds committed at least partly to further the employer's business, but does not encompass wrongs motivated by the employee's personal spite or

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29. These theories may also be described as primary and secondary liability theories. Individuals who violate direct duties owed to the plaintiff are primary wrongdoers, while those persons whose liabilities arise only because another has violated the law are secondary wrongdoers. Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification and Contribution*, 120 U. PA. L. REV. 597, 600 (1972).

30. For decisions in the RICO area, see *O'Brien v. Dean Witter Reynolds, Inc.* [1984 Transfer Binder] FED SEC. L. REP. (CCH) ¶ 91,509 (D. Ariz. 1984) ("knowing or intentional participation"); *Dakis v. Chapman*, 574 F. Supp. 757, 758-60 (N.D. Cal. 1983) ("actively engaged in the pattern of racketeering"). *Moss v. Morgan Stanley Inc.*, 553 F. Supp. 1347, 1361 (S.D.N.Y.), *aff'd on other grounds*, 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 1280 (1984), imposed an additional requirement of an interest in the criminal venture. See also RESTATEMENT (SECOND) OF AGENCY § 212 (1957).

31. RESTATEMENT (SECOND) OF AGENCY § 213(d) (1957).

32. *Id.* at § 216.

33. The origins of respondeat superior are disputed. Compare Holmes, *Agency I*, 4 HARV. L. REV. 345 (1891) (respondeat superior developed from Roman law) with Wigmore, *Responsibility for Tortious Acts: Its History*, 7 HARV L. REV. 315 (1894) (respondeat superior developed from Germanic law). It was firmly established as part of the common law by 1725. T. BATY, VICARIOUS LIABILITY 28-29 (1916) (as to negligent acts). Liability for willful acts, including fraud, developed in the second half of the nineteenth century. *Id.* at 84, 121.

34. See generally W. PROSSER, LAW OF TORTS §§ 69-70 (4th ed. 1971), F. HARPER & F. JAMES, JR., TORTS § 26.9 (1956); RESTATEMENT (SECOND) OF AGENCY §§ 216, 219(1), 231 (1957).

malice.<sup>35</sup> When the tortious conduct may result in the award of punitive damages or criminal penalties, however, the employer's liability may not be absolute. The Restatement Second of Agency states that punitive damages may be awarded against an employer only if there is some fault on its part or if the employee was employed in a managerial capacity and was acting in the scope of employment.<sup>36</sup> This rule, however, does not apply to treble damages statutes, "as to which no statement is made."<sup>37</sup> The Restatement says that an employer "may be subject" to penalties,<sup>38</sup> and the comments list the language of the statute and its objectives as factors to consider.<sup>39</sup>

## 2. *Apparent Authority*

When the employee's misconduct is outside the scope of employment, and the employer is not liable under respondeat superior, the employer will still be liable if there was reliance upon the agent's apparent authority, or if the employee was aided in accomplishing the tort by the existence of the agency relation.<sup>40</sup> Thus, the principal may be liable even if the tort was committed solely to advance the agent's personal illicit scheme.<sup>41</sup>

## 3. *Misrepresentations*

Finally, a principal is liable for its agent's misrepresentations that cause pecuniary loss, if the statement was authorized, apparently authorized, or within the power of the agent to make for the principal.<sup>42</sup> It does not matter that the agent is acting solely for his own purposes.<sup>43</sup>

Although the common law doctrines imposing vicarious liability are well established, their justification has been varied.<sup>44</sup> The pri-

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35. 2 F. HARPER & F. JAMES, JR., *THE LAW OF TORTS*, § 26.9 (1956). In *Moss v. Morgan Stanley Inc.*, 553 F. Supp. 1347, 1356 (S.D.N.Y.), *aff'd on other grounds*, 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 1280 (1984), the court stated that an investment banking firm could not be held derivatively liable for its employee's illegal insider trading activity, because such conduct was outside the scope of his employment.

36. RESTATEMENT (SECOND) OF AGENCY § 217C (1957).

37. *Id.* at § 217C, comment c.

38. *Id.* at § 217D.

39. *Id.*

40. *Id.* at § 219(2)(d).

41. *Id.* at §§ 261, 262, 265; see *American Society of Mechanical Engineers v. Hydrolevel Corp.*, 456 U.S. 556 (1982), discussed *infra* notes 80-87 and accompanying text.

42. RESTATEMENT (SECOND) OF AGENCY §§ 249, 257 (1957).

43. *Id.* at § 262.

44. Baty stated that there were nine bases for justifying respondeat superior: control, profit, revenge, carelessness, identification, evidence, indulgence, danger, satisfaction. T. BATY,

mary modern rationale is risk distribution: the use of respondeat superior to spread losses over a larger segment of the population has been viewed as efficacious policy.<sup>46</sup> This is sometimes referred to as enterprise liability; injuries caused by the employer's employees are simply costs of doing business that should be borne by the employer.<sup>46</sup> This rationale by itself may be sufficient justification.<sup>47</sup> In addition, modern theory extends risk distribution beyond the enterprise, to the general public<sup>48</sup> or at least to that part of general public that pays for the enterprise's products or services.<sup>49</sup> Another aspect of risk distribution is that it is another protection the state offers its workers, so their personal resources will not be exhausted because of a work-related tort.<sup>50</sup>

The use of respondeat superior is also justified as a deterrent. It encourages the employer to exercise greater care in hiring and supervising its employees, and thus is beneficial to society overall.<sup>51</sup>

### C. *The Cases*

There are only a few cases that raise the issue of respondeat superior or other agency theories of liability in civil RICO securities fraud cases.<sup>52</sup> As discussed above, most concern the liability of a securities firm for its employee's alleged churning and suitability violations.<sup>53</sup> These cases find that the registered representative can be

VICARIOUS LIABILITY 147-48 (1916). He concluded that "the real reason for employers' liability is the ninth; the damages are taken from a deep pocket." *Id.* at 154.

45. Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 YALE L.J. 499, 499 (1961); Smith, *Frolic and Detour*, 23 COLUM. L. REV. 444, 456-57 (1923); Laski, *The Basis of Vicarious Liability*, 26 YALE L.J. 105, 111-12 (1916); Seavey, *Speculations as to "Respondeat Superior,"* HARVARD LEGAL ESSAYS 433, 450 (1934).

46. Douglas, *Vicarious Liability and Administration of Risk I*, 38 YALE L.J. 584, 593-94 (1929).

47. Calabresi, *supra* note 45, at 514.

48. *Id.* at 527.

49. *Id.* at 518-19.

50. Laski, *The Basis of Vicarious Liability*, 26 YALE L.J. 105, 130 (1916).

51. *Id.* at 116; Seavey, *supra* note 45, at 447-48.

52. *O'Brien v. Dean Witter Reynolds, Inc.*, [1984 Transfer Binder] FED. SEC. L. REP (CCH) ¶ 91,509 (D. Ariz. 1984); *Yancoski v. E.F. Hutton & Co.*, 581 F. Supp. 88 (E.D. Pa. 1983); *Dakis v. Chapman*, 574 F. Supp. 757 (N.D. Cal. 1983); *Moss v. Morgan Stanley Inc.*, 553 F. Supp. 1347 (S.D.N.Y.), *aff'd*, 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 1280 (1984); *Parnes v. Heinold Commodities, Inc.*, 548 F. Supp. 20 (N.D. Ill. 1982). *See supra* note 7 and accompanying text.

53. There are other securities cases where the firm has been named as a defendant, but the issue of respondeat superior has not been addressed. In many of them, the courts found that no RICO claim has been stated, for a variety of reasons. The first four reasons cannot survive after the Supreme Court opinion in *Sedima and Harco*. *See supra* note 26.

1). RICO requires a link to organized crime; *Gilbert v. Prudential-Bache Securities*,

sued under section 1962(c), but not the firm employing him.<sup>54</sup> To

Inc., [1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,573 (E.D. Pa. 1984); *Aliberti v. E.F. Hutton & Co.*, 591 F. Supp. 632 (D. Mass. 1984); *Hokama v. E.F. Hutton & Co.*, 566 F. Supp. 636 (C.D. Cal. 1983); *Minpeco, S.A. v. ContiCommodity Services, Inc.*, 558 F. Supp. 1348 (S.D.N.Y. 1983); *Wagner v. Bear, Stearns & Co.*, [1982-83 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 99,032 (N.D. Ill. 1982); *Divco Constr. & Realty Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 575 F. Supp. 712 (S.D. Fla. 1983). An extensive list of cases on both sides is found in *re Catarella and E.F. Hutton & Co.*, 583 F. Supp. 1388 (E.D. Pa. 1984).

2). The purposes and intent of RICO were not directed toward the activities alleged against these defendants, *Noland v. Gurley*, 566 F. Supp. 210 (D. Cal. 1983).

3). Plaintiff lacks standing because no allegation of an injury "by reason of" a § 1962 violation, *Rush v. Oppenheimer & Co.*, 592 F. Supp. 1108 (S.D.N.Y. 1984); *Harper v. New Japan Securities International, Inc.*, 545 F. Supp. 1002 (C.D. Cal. 1982); *see supra* note 26 and accompanying text.

4). A prior conviction, *Rush v. Oppenheimer & Co.*, 592 F. Supp. 1108 (S.D.N.Y. 1984), *see supra* note 26, or probable cause, *Taylor v. Bear Stearns & Co.*, 572 F. Supp. 667 (N.D. Ga. 1983); *Bennett v. E. F. & Hutton Co.*, No. C83-1502A (N.D. Ohio Nov. 28, 1984), must be alleged with reference to the predicate acts.

5). There is no § 1962(d) claim because there cannot be a conspiracy between a corporation and its employee, *Landmark Savings & Loan v. Loeb Rhoades, Hornblower & Co.*, 527 F. Supp. 206 (E.D. Mich. 1981).

6). RICO was not meant to supplant fraud provisions of the federal securities laws. *Aliberti v. E.F. Hutton & Co.*, 591 F. Supp. 632 (D. Mass. 1984).

7). The complaint did not allege the existence of an "enterprise" apart from the predicate acts comprising the "pattern of racketeering activity." *Bennett v. E. F. Hutton & Co.*, No. C83-1502A (N.D. Ohio Nov. 28, 1984); *in re Catarella and E.F. Hutton & Co., Inc.*, 583 F. Supp. 1388 (E.D. Pa. 1984).

8). Failure to plead fraud with the requisite specificity, *see infra* note 64.

In the above cases, the issue of respondeat superior liability is not raised. In other cases, courts find that a RICO claim is stated, but still fail to address respondeat superior. *Heinold Commodities v. McCarty*, 513 F. Supp. 311 (N.D. Ill. 1979); *Jensen v. E.F. Hutton & Co.*, [1983-84 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 99,674 (C.D. Cal. 1984); *Kimmel v. Peterson*, 565 F. Supp. 476 (E.D. Pa. 1983) (it is not clear if the firm was a defendant); *Mauriber v. Shearson/American Express*, 567 F. Supp. 1231 (S.D.N.Y. 1983); *Austin v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 570 F. Supp. 667 (W.D. Mich. 1983); *Nunes v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [Current Developments] FED. SEC. L. REP. (CCH) ¶ 91,999 (D. Md. 1985). *See also Yancoski v. E.F. Hutton & Co.*, 581 F. Supp. 88 (E.D. Pa. 1983) (court allows RICO claim against registered representative, but not against firm, because it was the enterprise and not the person under § 1962(c), and because no intra-corporate conspiracy is possible under § 1962(d)). *Witt v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [Current Developments] FED. SEC. L. REP. ¶ 91,970 (W.D. Pa. 1985) (claim against firm dismissed; it was the enterprise and not the person under § 1962(c)).

54. *O'Brien v. Dean Witter Reynolds, Inc.*, [1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,509 (D. Ariz. 1984); *Dakis v. Chapman*, 574 F. Supp. 757 (N.D. Cal. 1983). *Cf. Parnes v. Heinold Commodities, Inc.*, 548 F. Supp. 20 (N.D. Ill. 1982); *Yancoski v. E.F. Hutton & Co., Inc.*, 581 F. Supp. 88 (E. Pa. 1983) (claims dismissed as to securities firms in both cases).

It is the "person employed . . . by any enterprise" who is primarily liable under section 1962(c), not the "enterprise." *See United States v. Hartley*, 678 F.2d 961 (11th Cir. 1982), *cert. denied*, 459 U.S. 1170 (1983). Under the most reasonable statutory interpretation, this "person" is the registered representative who engaged in the illegal activities, and the securities firm is the "enterprise." An alternative reading is possible: the firm is the "person" and is

date, courts refuse to attribute the registered representative's misconduct to the employer. Instead, they acknowledge the potential liability against a firm only on a fault basis, and only with proof of the firm's participation in the fraud. In *Moss v. Morgan Stanley Inc.*,<sup>55</sup> the district court reasoned that section 1961 only defines an act as "racketeering" if it is one of the enumerated felonies punishable under the laws of the United States. The elements of the criminal offense of aiding and abetting must be established to hold the firm liable. This requires both knowing participation in the offense and an interest in the criminal venture.<sup>56</sup> Other courts have held that a firm would be liable if knowing or intentional participation in the wrongful acts could be established;<sup>57</sup> these courts did not require additionally an interest in the criminal venture. None of these cases has recognized the possibility of a firm's liability for negligent or reckless hiring or supervision of its employees.<sup>58</sup>

Furthermore, all the cases have rejected without extended analysis the possibility that no-fault theories might be available as a basis for rendering a judgment against the firm without extended analysis. In *O'Brien v. Dean Witter Reynolds, Inc.*, the court, emphasizing the requirement of knowing participation, simply stated that an employee's knowledge could not be imputed to the employer.<sup>59</sup> The court in *Dakis v. Chapman* stressed the concept of intentional participation;<sup>60</sup> RICO liability would attach to an "aggressor" enterprise and not to a firm that was merely a "conduit" for the employee's

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primarily liable if the misdeeds of its employee are attributable to it. The statutorily required "enterprise," under this interpretation, would have to be the individual broker, *Parnes v. Heindol Commodities, Inc.*, 548 F. Supp. 20, 24 ("a strained reverse construction"), or the customer or the customer's investment portfolio. See *Dakis v. Chapman*, 574 F. Supp. 757, 760 (D. Cal. 1983); *O'Brien v. Dean Witter Reynolds*, slip op. at 7. The latter interpretation is a strained construction of the statute. But see *In re Catanella and E.F. Hutton & Co.*, 583 F. Supp. 1388 (E.D. Pa. 1984) ("no conceivable reading of the statutory definition would support a conclusion that securities accounts qualify as 'enterprises.'"). Moreover, under either interpretation, the same issue is presented, namely whether to attribute the registered representative's misconduct to the employer.

55. 553 F. Supp. 1347 (S.D.N.Y.), *aff'd on other grounds*, 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 1280 (1984). The court stated that even if a civil standard were adopted, the enterprise would not have a separate economic existence apart from the pattern of racketeering activity. The Second Circuit found that the district court erred on this one point. *Id.* at 22-23.

56. 553 F. Supp. at 1362.

57. *O'Brien v. Dean Witter Reynolds, Inc.*, No. CIV 82-1605 PHX CLH, slip. op. at 9 (D. Ariz. Mar. 26, 1984); *Dakis v. Chapman*, 574 F. Supp. 757, 759-60 (D. Cal. 1983).

58. *Id.*

59. *O'Brien v. Dean Witter Reynolds, Inc.*, No. CIV 82-1605, PHX CLH, slip. op. at 9 (D. Ariz. Mar. 26, 1984).

60. *Dakis*, 574 F. Supp. at 759-60.

securities violations.<sup>61</sup> In *Parnes v. Heinold Commodities, Inc.* the court described the use of respondeat superior in this situation as "bizarre," noting that the firm itself had been victimized by its unscrupulous employee.<sup>62</sup> The tenor of these opinions is sympathy for the firm and a refusal to add to its injury by permitting liability to be thrust upon it by the wrongful acts of its employees.<sup>63</sup> Thus, these cases require, at a minimum, knowing participation in the employee's fraud to hold the firm liable for RICO treble damages.<sup>64</sup>

Because the analysis in these cases is so abbreviated, it cannot be assumed that the respondeat superior theory issue is settled. Rejection of respondeat superior liability in this context seems an abrupt departure from modern tort principles; not since the early twentieth century have there been such strong expressions about the injustice of holding an innocent principal liable for the misdeeds of its agents.<sup>65</sup> Moreover, the policies served by respondeat superior—loss distribution and deterrence—seem to be furthered by its application to RICO. Furthermore, Congress provided that RICO is to be "liberally construed to effectuate its remedial purposes."<sup>66</sup> Finally, a majority of the circuit courts hold that respondeat superior is available under the federal securities laws for the predicate offenses of churning and suitability. Thus, these considerations require strong arguments for rejecting respondeat superior.

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61. *Id.*

62. *Parnes v. Heinold Commodities, Inc.*, 548 F. Supp. 20, 24 n.9 (N.D. Ill. 1982).

63. *Id.* at 23-24 n.8.

64. Rule 9(b) of the Federal Rules of Civil Procedure requires specificity in pleading fraud. This requirement has been applied to RICO pleadings. *Taylor v. Bear Stearns & Co.*, 572 F. Supp. 667, 682 (N.D. Ga. 1983); *Bennett v. E.F. Hutton & Co.*, No. C83-1502A (N.D. Ohio Nov. 28, 1984).

Another unresolved issue, assuming that a plaintiff could adequately allege knowing participation by the firm, is what difficulties plaintiff might encounter from the possible application of antitrust's intracorporate conspiracy doctrine. *Yancoski v. E.F. Hutton & Co., Inc.*, 581 F. Supp. 88, 97 (E.D. Pa. 1983) and *Landmark Sav. & Loan Ass'n. v. Loeb Rhoades*, 527 F. Supp. 206, 209 (E.D. Mich. 1981) applied the doctrine to dismiss § 1962(d) claims, while *Mauriber v. Shearson/American Express*, 567 F. Supp. 1231, 1241 (S.D.N.Y. 1983), rejected the doctrine in a § 1962(d) claim. All these decisions predated the Supreme Court's adoption of the doctrine in the antitrust area in *Copperweld Corp. v. Independent Tube Corp.*, 1984-2 TRADE CASES (CCH) ¶ 66,901 (Sup. Ct. 1984).

65. Holmes "assume[d] that common-sense is opposed to making one man pay for another man's wrong, unless he actually has brought the wrong to pass according to the ordinary canons of legal responsibility . . . ." Holmes, *Agency II*, 5 HARV. L. REV. 1, 14 (1891). Baty stated that the real reason for employers' liability is their "deep pocket." T. BATY, VICARIOUS LIABILITY 154 (1916). Cf. Seavey, *supra* note 45, at 433-35.

66. Racketeer Influenced and Corrupt Organizations Act, Pub. L. No. 91-452, § 904(a), 84 Stat. 941, 947 (1971).

### III. APPLICATION OF RESPONDEAT SUPERIOR AND AGENCY PRINCIPLES IN OTHER AREAS OF FEDERAL LAW

This section examines the courts' treatment of respondeat superior liability under other federal statutes. Rather than attempt a comprehensive examination of the many federal statutory schemes where the issue has arisen, this section reviews selected federal statutes and ascertains factors courts use to determine whether respondeat superior liability should be applied to a particular statute. Antitrust law is selected<sup>67</sup> because Congress frequently referred to its remedies as a model for RICO's civil remedies.<sup>68</sup> Securities laws are examined,<sup>69</sup> because violations of these statutes are the predicate offenses that form the basis of the RICO violation.<sup>70</sup> Commodities laws are examined<sup>71</sup> because the violations are similar to securities violations, and, again, can form the basis of a RICO violation.<sup>72</sup> While less relevant, the treatment of respondeat superior under civil rights statutes<sup>73</sup> shows the emphasis given to statutory language and legislative history. Finally, cases arising under other federal statutes are reviewed: employment discrimination,<sup>74</sup> labor law,<sup>75</sup> and false claims.<sup>76</sup>

There is a general judicial acceptance for applying common law agency principles to federal statutes.<sup>77</sup> Nevertheless, courts recognize that congressional intent must prevail and thus they look to the statutory language in the first instance to determine that intent. In some instances, as under section 1983 of Civil Rights Act, the literal language will supply an all but conclusive answer. In other instances, as in antitrust law, the statute is silent as to intent, or subject to differ-

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67. See *infra* notes 79-87 and accompanying text.

68. E.g., 116 CONG. REC. 35,196, 35,197, 35,201, 35,295.

69. See *infra* notes 88-106 and accompanying text.

70. See *supra* notes 7-10 and accompanying text.

71. See *infra* notes 107-26 and accompanying text.

72. See *infra* notes 107-08 and accompanying text.

73. See *infra* notes 127-34 and accompanying text.

74. See *infra* notes 135-43 and accompanying text.

75. See *infra* notes 144-47 and accompanying text.

76. See *infra* notes 148-52 and accompanying text.

77. American Society of Mechanical Engineers v. Hydrolevel Corp., 456 U.S. 567, 569 (1982). But see Northwest Airlines v. Transport Workers Union, 451 U.S. 77 (1981) and Texas Ind. v. Radcliff Materials, Inc., 451 U.S. 630 (1981), where the court found no contribution under the Equal Pay Act and Title VII of the Civil Rights Act of 1964 and § 4 of the Clayton Act. The court reasoned that Congress expressly created these private damages actions and failed to provide for contribution, although the express contribution provisions in the securities laws Securities Act § 11(f), 15 U.S.C. § 77(k)(f)(1933) and Securities Act § 18(b), 15 U.S.C. § 78(i)(e)(1934) demonstrated that Congress knew how to do this when it wished.

ent interpretations, as under the securities and commodities statutes. Courts will then examine legislative history to aid in interpreting the statutory language. Finally, the courts will analyze the legislative purpose to determine if the statutory purposes would be furthered by application of respondeat superior.

In addition, courts have expressed sympathy for the principal who is made to pay for his agents' transgressions. This attitude parallels earlier arguments opposing respondeat superior theory.<sup>78</sup> This has led to a dilution of classic respondeat superior theory, especially in the areas of employment discrimination and labor relations.

A fifth factor is whether courts characterize the statute as compensatory or penal. In the latter instances, courts show a greater reluctance to impose respondeat superior liability on a principal, as illustrated by case law under the false claims act.

#### A. *Antitrust Law*

Congress frequently referred to the civil remedies of the antitrust statutes as a model for RICO's civil remedies,<sup>79</sup> and RICO's treble damages remedy bears a close resemblance to the antitrust remedy. Thus, examining the application of common law agency principles under the antitrust law seems especially appropriate.

In *American Society of Mechanical Engineers v. Hydrolevel Corp.*,<sup>80</sup> the United States Supreme Court held that a nonprofit standard-setting organization was civilly liable for treble damages for the acts of its agents which were within the agents' apparent authority.<sup>81</sup> The Court first examined general rules of agency law and stated that these principles have "long been the settled rule in the federal system."<sup>82</sup> It then found that Congress intended the antitrust laws to have broad remedial effect in order to encourage competition. Hence, courts should apply general agency principles that would further this intent.<sup>83</sup> The Court emphasized that the imposition of liability would have a deterrent effect on the organization and that this would provide an incentive to insure that similar anticompetitive

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78. See generally T. BATY, VICARIOUS LIABILITY (1916).

79. See *supra* note 68.

80. 456 U.S. 556 (1982).

81. Members of the society had prepared and disseminated an advisory opinion that a competitor's safety device for boilers did not satisfy the code's requirements. Respondeat superior liability was not applicable since the individuals acted solely because of personal motives and therefore not within the scope of their employment. See *supra* notes 34-35 and 40-41 and accompanying text.

82. 456 U.S. at 567.

83. *Id.* at 569.

practices would not occur in the future.<sup>84</sup>

The defendant argued that traditional agency principles did not hold a principal liable in tort actions involving punitive damages.<sup>85</sup> The Court rejected this argument, emphasizing the deterrent purpose of the treble damages remedy and de-emphasizing its punitive aspects.<sup>86</sup> Thus, as the dissent correctly noted, "[t]he underlying theme of the Court's opinion seems to be that any rule of agency law that widens the net of antitrust enforcement and liability should be adopted."<sup>87</sup>

## B. Securities Law

Because the predicate acts that are the basis of the RICO violation are federal securities violations, and principally section 10(b) of the Exchange Act and its Rule 10b-5,<sup>88</sup> judicial discussion of respondeat superior liability in this area provides an analogy.<sup>89</sup> There is,

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84. *Id.* at 572.

85. *Id.* at 574-75.

86. *Id.* at 575.

87. *Id.* at 590. The opinion was a 5-1-3 decision, with Chief Justice Burger concurring in the result only, and Justice Powell writing a dissent. Justice Powell was concerned about the consequences of extending the exposure of nonprofit organizations that perform valuable functions, such as setting industry safety standards, to treble damage liability. *Id.* at 586. In addition, he reviewed the law of agency as it existed at the time of enactment of the Sherman Act and found it inapplicable to nonprofit organizations and in punitive damage actions. *Id.* at 586-89. Finally, he argued that under substantive law he found no conspiracy, since the society was as much a victim of plaintiff's competitors as plaintiff was. *Id.* at 592 n.18.

88. *See supra* notes 13-16, 21 and accompanying text.

89. There is extensive case law on this issue. Respondeat superior applicable: *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111 (5th Cir. 1980) (employee of brokerage firm engaged in market manipulation); *Holloway v. Howerdd*, 536 F.2d 690 (6th Cir. 1976) (brokerage firm's employee sold unregistered securities); *Fey v. Walston & Co.*, 493 F.2d 1036 (7th Cir. 1974) (brokerage firm churned customer's account); *Marbury Management, Inc. v. Kohn*, 629 F.2d 705 (2d Cir.), *cert. denied*, 449 U.S. 1011 (1980) (brokerage firm's trainee made misrepresentations as to his expertise) (opinion discusses prior cases in Second Circuit, which were conflicting). In the First Circuit, *A.J. White & Co. v. SEC*, 556 F.2d 619 (1st Cir.), *cert. denied*, 434 U.S. 969 (1977), and *Holmes v. Bateson*, 583 F.2d 542 (1st Cir. 1978), are often cited for the proposition, although they are not directly on point; *Kravitz v. Pressman, Frohlich & Frost, Inc.*, 447 F. Supp. 203 (D. Mass. 1978) is on point (brokerage firm's employee churned customer's account). In *Carras v. Burns*, 516 F.2d 251 (4th Cir. 1975), the Fourth Circuit applied respondeat superior principles to hold a brokerage firm liable for its employee's churning, but one district court believes that this decision was overruled in *Carpenter v. Harris, Upham & Co.*, 594 F.2d 388 (4th Cir.), *cert. denied*, 444 U.S. 868 (1979), although the latter opinion is concerned solely with controlling a person's liability and has nothing to do with respondeat superior, since the employee had left the firm at the time of the transactions causing the plaintiff's harm. Compare *Haynes v. Anderson & Strudwick*, 508 F. Supp. 1303 (E.D. Va. 1981) (*Carras* overruled) with *Frankel v. Wyllie & Thronhill, Inc.*, 537 F. Supp. 730 (W.D. Va. 1982) (*Carras* not overruled). In the Third Circuit, *Sharp v. Coopers & Lybrand*, 649 F.2d 175 (3rd Cir. 1981), *cert. denied*, 455 U.S.

however, a significant difference between RICO and the Exchange Act. The private remedy under section 10(b) and Rule 10b-5 is judicially implied; thus, the courts have more extensively relied on policy considerations in interpreting the scope of the remedy.<sup>90</sup> Congress, on the other hand, expressly provided for private enforcement of RICO. Therefore, statutory language and Congressional intent—not the judiciary's perception of appropriate policy—should determine the remedy's scope.

In addition, analysis of the applicability of respondeat superior principles to the Rule 10b-5 remedy is complicated by section 20(a) of the Exchange Act, which imposes liability on "controlling persons" but affords them a "good faith" defense.<sup>91</sup> The courts are divided as to whether Congress intended the controlling persons provision to be the exclusive basis for imposing liability on employers for their employees' misdeeds, which would require the interpretation that Congress rejected the use of respondeat superior principles.

While the Supreme Court, in *Affiliated Ute Citizens v. United States*,<sup>92</sup> held that a bank was vicariously liable for the Rule 10b-5

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938 (1982), held that a firm would be liable for its employee's wrongful acts where its conduct is likely to exert strong influence on important investment decisions, as in the case of a brokerage firm or where the employee is a high level officer or director, or both. *Id.* at 181-82. There an accounting firm was held liable for misstatements contained in a tax opinion used to market a tax shelter program. While *Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880 (3d Cir. 1975) is cited as stating the general rule of the circuit of the nonapplicability of respondeat superior, a reading of the facts in the case makes it clear that respondeat superior was there inapplicable because the corporate officer was not acting in the scope of his employment. Both the lower and circuit court opinions acknowledged this. The positions of the Eighth and Tenth Circuits are unclear. In *Myzel v. Fields*, 386 F.2d 718 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968), the court refers to common law agency principles, but it is unclear whether it is relying on agency principles or § 20(a) of the Exchange Act to find defendants liable. The Tenth Circuit, in *Kerbs v. Fall River Indus., Inc.*, 502 F.2d 731 (10th Cir. 1974), apparently believed that *state law* agency concepts should be applied to hold a corporation liable for its president's fraud and deceit.

The only circuit that flatly denies any application of respondeat superior principles, the Ninth, does so in reliance on an opinion which did not present the issue, *Kamen v. Paul H. Aschkar & Co.*, 382 F.2d 689 (9th Cir. 1967), *cert. dismissed*, 393 U.S. 801 (1967). See *Christoffel v. E.F. Hutton & Co.*, 588 F.2d 665 (9th Cir. 1978) (law of this circuit that § 20(a) supplants vicarious liability of employer for acts of employee under respondeat superior); *Zweig v. Hearst Corp.*, 521 F.2d 1129 (9th Cir. (1975)), *cert. denied*, 423 U.S. 1025.

90. For years, the prevalent approach in the lower courts was to view the scope of Rule 10b-5 expansively, but in recent years the Supreme Court has reversed this trend by emphasizing that the remedy is an implied one. *E.g.*, *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 734-36 (1975).

91. 15 U.S.C. § 78(a) (1982).

92. 406 U.S. 128 (1972). A few opinions do cite *Affiliated Ute* as authority, *e.g.*, *Carras v. Burns*, 516 F.2d 251, 260-61 (4th Cir. 1975); *Fey v. Walston & Co., Inc.*, 493 F.2d 1036, 1053 (7th Cir. 1974).

violations of its employees, circuit courts have not viewed this decision as controlling. Disregard of Supreme Court precedent is appropriate here, because the Court decided the issue without analysis.<sup>93</sup> In addition, *Affiliated Ute* predates the Supreme Court's opinions on Rule 10b-5 which pay closer attention to the statute as a whole and attempt to harmonize the implied remedy with the express remedies.<sup>94</sup>

The two best arguments for rejection are consistent with the Supreme Court's trend to restrict the scope of Rule 10b-5's implied remedy by emphasizing the statutory framework. First, the Supreme Court, in *Ernst & Ernst v. Hochfelder*,<sup>95</sup> concluded, after examining both the language of section 10(b) and the overall statutory scheme, that primary liability under Rule 10b-5 required scienter. Opponents of respondeat superior argue from this that no-fault liability is antithetical to the statute.<sup>96</sup> This conclusion, however, does not distinguish between primary and secondary liability. *Hochfelder* holds that no one is liable under Rule 10b-5 unless the primary violator acted with scienter; nevertheless, *Hochfelder* does not mandate the conclusion that scienter is required to impose secondary liability on the primary violator's principal.

The second argument for rejecting respondeat superior examines the legislative history and concludes that Congress intended to restrict the scope of vicarious liability when it enacted section 20(a) of the Exchange Act. While the Senate version of the section contained an "insurer's liability" standard, the House version, which was subsequently adopted, proposed a "fiduciary standard" which

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93. "The liability of the bank, of course, is coextensive with that of [employees] Gale and Haslem." *Affiliated Ute*, 406 U.S. at 154.

94. *Chiarella v. United States*, 445 U.S. 222 (1980); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).

95. 425 U.S. 185 (1976).

96. *Id.* at 212. The argument derived from *Hochfelder* is set forth at Fischel, *Secondary Liability Under § 10(b)*, 69 CAL. L. REV. 80, 88 (1981); see also Fitzpatrick & Carmen, *Respondeat Superior and the Federal Securities Laws: A Round Peg in a Square Hole*, 12 HOFSTRA L. REV. 1, 2 (1983) (respondeat superior inapplicable). For contrasting views, see Ferrara & Sanger, *Derivative Liability in Securities Law: Controlling Person Liability, Respondeat Superior, and Aiding and Abetting*, 40 WASH. & LEE L. REV. 1007 (1983); Musewicz, *Vicarious Employer Liability and § 10(b): In Defense of the Common Law*, 50 GEO. WASH. L. REV. 754 (1982); Note, *Rule 10b-5 and Vicarious Liability Based on Respondeat Superior*, 69 CAL. L. REV. 1513 (1981) (respondeat superior applicable). The seminal piece in the area, which predates *Hochfelder*, is Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification and Contribution*, 10 U. PA. L. REV. 597 (1972).

imposed a duty of due care.<sup>97</sup> Adoption of the House version makes it clear that Congress intended liability to be imposed on controlling persons only if they participated in the controlled persons' fraud.<sup>98</sup> Application of respondeat superior principles, therefore, would nullify the "good faith" defense of section 20(a) and would be contrary to this legislative intent. On the other hand, in the view of courts applying respondeat superior, Congress's intent, in enacting section 20(a), was to impose liability on persons who actually control the wrongdoer but would not be reachable under common law agency principles. Because the statute extended liability beyond that under the common law, Congress provided affected persons with the statutory defense of due care.<sup>99</sup> Congress intended, however, that traditional agency principles would apply under the statute.

Apart from the Ninth, all the circuits that have considered the question have applied respondeat superior principles, at least in some circumstances.<sup>100</sup> They have emphasized the legislation's remedial nature and goal of protecting investors.<sup>101</sup> To achieve this goal the courts have applied common law agency principles.<sup>102</sup> Congress, these courts reason, could not have intended section 20(a) to insulate

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97. S. REP. NO. 47, 73d Cong., 1st Sess. 5 (1933); H.R. REP. NO. 85, 73d Cong., 1st Sess. 5 (1933); H.R. REP. NO. 152, 73d Cong., 1st Sess. 27 (1933).

98. *Rochez Brothers, Inc. v. Rhoades*, 527 F.2d 880, 885 (3d Cir. 1975); *Lanza v. Drexel & Co.*, 479 F.2d 1277, 1299 (2d Cir. 1973). For current views in the Third and Second Circuits, see, respectively, *Sharp v. Coopers & Lybrand*, 649 F.2d 175 (3d Cir. 1981), *cert. denied*, 455 U.S. 938 (1982), and *Marbury Management, Inc. v. Kohn*, 629 F.2d 705 (2d Cir.), *cert. denied*, 449 U.S. 1011 (1980).

99. *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111 (5th Cir. 1980); *Marbury Management, Inc. v. Kohn*, 629 F.2d 705 (2d Cir.), *cert. denied*, 449 U.S. 1011 (1980); *Carpenter v. Harris, Upham & Co., Inc.*, 594 F.2d 388 (4th Cir.), *cert. denied*, 444 U.S. 868 (1979); *Kravitz v. Pressman, Frohlich & Frost Inc.*, 447 F. Supp. 203 (D. Mass. 1978).

100. *See supra* note 89.

101. *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1118 (5th Cir. 1980); *Marbury Management, Inc. v. Kohn*, 629 F.2d 705, 716 (2d Cir.), *cert. denied*, 449 U.S. 1011 (1980); *Holloway v. Howerdd*, 536 F.2d 690, 694-695 (6th Cir. 1976); *Carroll v. First National Bank of Lincolnwood*, 413 F.2d 353, 358 (7th Cir. 1969), *cert. denied*, 396 U.S. 1003 (1970); *Kravitz v. Pressman, Frohlich & Frost*, 447 F. Supp. 203, 214 (D. Mass. 1978).

102. *Marbury Management, Inc. v. Kohn*, 629 F.2d 705, 716 (2d Cir.), *cert. denied*, 449 U.S. 1011 (1980); *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1118 (5th Cir.); *Holloway v. Howerdd*, 536 F.2d 690, 694-95 (6th Cir. 1976); *Fey v. Walston & Co.*, 493 F.2d 1036, 1052 (7th Cir. 1974).

As authority for this proposition, some of the opinions rely on § 28(a) of the Exchange Act, 15 U.S.C. § 78bb(a) (1982) and § 16 of the Securities Act, 15 U.S.C. § 77p (1982) which merely make it clear that state remedies are not affected by the federal statutes. *Marbury Management v. Kohn*, 629 F.2d 705, 716 (2d Cir.), *cert. denied*, 449 U.S. 1011 (1980); *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1118 (5th Cir. 1980).

firms from the misdeeds of their employees,<sup>103</sup> particularly where the nature of the employer's business is such that it is likely to affect the investing public, like a brokerage firm.<sup>104</sup> Several opinions emphasize that the investor may have selected the firm for its reputation, and not for the registered representative he dealt with.<sup>105</sup> Hence, the firm itself actually provided the opportunity for the employee to defraud the customer and the firm should be held liable for that employee's fraud.<sup>106</sup>

### C. *Commodities Law*

Commodities fraud offenses, typically involving churning and unsuitability allegations<sup>107</sup> brought under the Commodity Exchange Act (the "CEA"),<sup>108</sup> are the common predicate offenses which underly many RICO actions. The applicability of respondeat superior to the CEA is unsettled. Policy arguments similar to those supporting the application of respondeat superior in securities law may be made,<sup>109</sup> but resolution of the issue in commodities law will probably be resolved through judicial determination of the appropriate relationship among the several statutory provisions.

Prior to the Supreme Court's opinion in *Curran v. Merrill Lynch Pierce Fenner & Smith*,<sup>110</sup> courts had split on whether to imply a private claim for damages under the CEA.<sup>111</sup> *Curran* held that there was such an implied remedy, and because of its concern about

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103. *Johns Hopkins University v. Hutton*, 422 F.2d 1124 (4th Cir. 1970), *cert. denied*, 416 U.S. 916 (1974). Another court feared that unless respondeat superior was recognized, accounting firms would have an incentive to create a "Chinese wall" between the partners and employees, with only the latter drafting opinions, *Sharp v. Coopers & Lybrand*, 649 F.2d 175 (3d Cir. 1981).

104. *Sharp v. Coopers & Lybrand*, 649 F.2d 175, 181 (3d Cir. 1981); *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1118-19 (5th Cir. 1980); *Holloway v. Howerdd*, 536 F.2d 690, 695 (6th Cir. 1976).

105. *Paul F. Newton & Co. v. Texas Commerce Bank*, 639 F.2d 1111, 1118-19 (5th Cir. 1980); *Holloway v. Howerdd* 537 F.2d 690, 696 (6th Cir. 1976).

106. *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1118-19 (6th Cir. 1976).

107. *Parnes v. Heinold Commodities, Inc.* 548 F. Supp. 20 (N.D. Ill. 1982); *Heinold Commodities, Inc. v. McCarty*, 513 F. Supp. 311 (N.D. Ill. 1979); *Jensen v. E.F. Hutton & Co.*, [1983-84 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 99,674 (C.D. Cal. 1984); *Minpeco, S.A. v. ContiCommodity Services, Inc.*, 558 F. Supp. 1348 (S.D.N.Y. 1983). Plaintiffs rely on violations of the mail and wire fraud statutes to establish the requisite predicate offenses. See *supra* notes 15-16 and accompanying text.

108. 7 U.S.C. §§ 1-26 (1982).

109. See *supra* notes 101-106 and accompanying text.

110. 456 U.S. 353 (1982).

111. For a full discussion of the state of the law prior to *Curran*, see *Leist v. Simplot*, 638 F.2d 283, 296-302 (2d Cir. 1980), which was one of the opinions affirmed in *Curran*.

the uncertain scope of the implied remedy,<sup>112</sup> the commodities industry pressured Congress to provide certainty by enacting express remedies which would be exclusive. Congress did so in the 1982 amendments to the CEA.<sup>113</sup> Section 22 of the CEA<sup>114</sup> gives a customer a cause of action for damages against his broker or advisor for churning, as well as against anyone "who willfully aids, abets, counsels, induces, or procures the commission" of the churning.<sup>115</sup> In addition, the 1982 amendments provide, in section 13(a),<sup>116</sup> that willful aiders and abettors are liable along with primary violators in both administrative and private suits.<sup>117</sup> Section 13(b) of the amended CEA<sup>118</sup> imposes liability in administrative actions on controlling persons for the violations of the controlled persons, provided that the Commodities Futures Trading Commission ("CFTC") proves that the controlling person did not act in good faith or did knowingly induce the violation.<sup>119</sup> Finally, section 22(a) provides that the statutory remedies are exclusive.<sup>120</sup>

The inclusion, in sections 13(a) and 13(b), of some forms of derivative liability suggests that Congress did not intend respondeat superior as a basis of liability. This argument is strengthened by section 22(a). On the other hand, section 2(a)(1)(A) of the CEA<sup>121</sup> is located in the definitional section, and as interpreted by the CFTC and by the courts prior to the 1982 amendments,<sup>122</sup> codifies the doctrine of respondeat superior as it applies to the statute by providing that an agent's act within the scope of his employment is the act of the principal. This provision has been part of the statute since 1922 and was unchanged by the 1982 amendments.

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112. The Commodities Futures Trading Comm'n took the position that no additional statutory remedies were necessary after *Curran* and did not undertake to develop statutory language for private rights of action. H.R. REP. NO. 565 (Pt. I), 97th Cong., 2d Sess. 157, reprinted in 1982 U.S. CODE CONG. & AD. NEWS 3871, 4006.

113. Futures Trading Act of 1982, Pub. L. No. 97-444, § 235, 96 Stat. 2294, 2322 (1983).

114. 7 U.S.C. § 25 (1982).

115. 7 U.S.C. § 25(a)(1) (1982).

116. 7 U.S.C. § 13c(a) (1982).

117. *Id.*

118. 7 U.S.C. § 13c(b)(2) (1982).

119. *Id.*

120. 7 U.S.C. § 25 (a)(2) (1982).

121. 7 U.S.C. § 4 (1982).

122. *Poplar Grove Planting & Refining Co. v. Bache Halsey Stuart, Inc.*, 465 F. Supp 585, 589 (M.D. La.), remanded on other grounds, 600 F.2d 1189 (5th Cir. 1979); *CFTC v. Commodities Fluctuations System, Inc.*, 583 F. Supp. 1382, 1383 (S.D.N.Y. 1984). See generally Markham and Meltzer, *Secondary Liability Under the Commodity Exchange Act*, 27 EMORY L.J. 1115 (1978).

Moreover, the legislative history of the 1982 amendments adds to the confusion. The House report stated that section 13(b) was added to enable the CFTC "to reach behind corporate or partnership entities" in order to impose sanctions on the persons that instigate the violations. The report compared that section to the controlling persons provision in the federal securities laws.<sup>123</sup> This language supports an interpretation of section 13(b) as an additional liability provision, and would treat the section consistently with the view of the majority of the circuits regarding the controlling persons provisions in the federal securities laws.<sup>124</sup> On the other hand, the committee report, in discussing section 13(b), stated that respondeat superior did not coexist with the controlling person liability imposed by that section because the section was drafted to protect controlling persons against too expansive a scope of liability.<sup>125</sup> The committee report apparently states that respondeat superior is not applicable to commodities fraud violations. But such a view requires that section 2(a)(1)(A) be read out of the statute. In all likelihood, the committee report intended that respondeat superior principles should not be used to impose liability on controlling persons where the common law would not be applicable; *i.e.*, the controlling person provision imposes liability on persons not reachable under section 2(a)(1)(A). Respondeat superior would then continue to be applicable in private

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123. H.R. REP. NO. 565 (pt. 1), 94th Cong., 2d Sess. 53, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3891, 3902. ("Among other things, this provision would strengthen the Commission's ability to impose sanctions against individuals who are, in essence, the alter egos of corporations which have duties under the Act."). *See also id.* at 142, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS at 3991 (§ 13(b) liability of an executive officer of a corporation or a supervising employee).

124. *See supra* note 99 and accompanying text.

125. "[Section 2(a)(1)] has been included in the Act for many years and in essence provides *respondeat superior* and general principal-agent standards for imposing liability on employers and principals for the acts of their employees or agents. The conferees intend that this section not be used as a basis for imputing liability to a controlling person of a firm for acts of an employee or agent of the firm since it does not include the protections that have carefully been articulated in the *Conference* substitute and would make a nullity of that provision." H.R. REP. NO. 964, 97th Cong., 2d Sess. 48, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 4055, 4066; H.R. REP. NO. 565 (pt. 1), 97th Cong., 2d Sess. 105, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3871, 3954.

The inclusion of this language may be explained by the legislative history of § 13(b). The issue of who would have the burden of proof in establishing the controlling person's good faith or lack of it was debated. The CFTC lost its effort to place the burden on the controlling person to show he acted in good faith and did not induce the violation. Congressional concern was expressed that the CFTC might use § 2(a)(1) to establish liability of a controlling person for acts of those under his control; the CFTC gave its assurance that this would not be attempted. H.R. REP. NO. 565 (Pt. 1), 97th Cong., 2d Sess. 142, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3871, 3454.

actions under the CEA, because section 13(b) is only applicable to actions brought by the CFTC, and probably in administrative actions as well.<sup>126</sup>

#### D. *Civil Rights Law*

While the civil rights statutes are not substantively related to RICO, the judicial treatment of respondeat superior liability under these provisions is worthy of examination because it provides a striking example of the Supreme Court's emphasis on statutory language and legislative history.

In *Monell v. Department of Social Services*,<sup>127</sup> the Supreme Court stated, in dictum, that a local government could not be held liable on a respondeat superior theory under the Civil Rights Act of 1871, 42 U.S.C. Section 1983. It emphasized that the statutory language<sup>128</sup> plainly imposed liability on a government when its employee violated someone's civil rights by following that government's official policy. Nevertheless, the Court found that the statutory language could not easily be read to impose vicarious liability on a government merely because it employed someone who violated another's rights.<sup>129</sup>

*Monell* is also an example of the use of legislative history to support a statutory interpretation. The Court noted that Congress specifically rejected a form of vicarious liability when it adopted the civil rights act, and was motivated partly by concerns about its constitutionality. While recognizing that rejection of one form of respondeat superior liability does not necessarily imply rejection of another form, the Court nevertheless found that "the inference that Congress

126. Even if Congress meant to eliminate respondeat superior altogether, a committee report cannot delete a provision from the statute. A. BROMBERG & L. LOWENFELS, *SECURITIES FRAUD & COMMODITIES FRAUD* § 4.6(463)(13) (1984).

127. 436 U.S. 658 (1978). *Monell* involved female employees of the Dep't of Social Servs. and the Bd. of Educ. of New York City who brought a class action against the Department and its Commissioner, the Board and its Chancellor, and the City of New York and its Mayor, charging that the Board and the Department had, as a matter of official policy, compelled pregnant employees to take unpaid leaves of absence without regard to medical reasons.

128. *Any person who, under color of any law, statute, ordinance, regulation, custom, or usage of any State subjects, or causes to be subjected, any person . . . to the deprivation of any rights, privileges, or immunities secured by the Constitution . . . shall . . . be liable . . . to the party injured in any action at law, suit in equity, or other proper proceeding for redress . . .*

436 U.S. 658, 691-92 (1978) (emphasis added).

129. 436 U.S. at 692. "Indeed, the fact that Congress did specifically provide that A's tort became B's liability if B 'caused' A to subject another to a tort suggests that Congress did not intend § 1983 liability to attach where such causation was absent." *Id.*

did not intend to impose such liability was quite strong.”<sup>130</sup> Moreover, while the remedial purposes of section 1983 would be furthered by application of respondeat superior, through both of the doctrine’s underlying justifications—loss distribution and deterrence—the Court concluded that Congress was aware of these considerations and had implicitly rejected them.<sup>131</sup>

*Monell* has been extended to allegations of civil rights deprivations under other federal statutes<sup>132</sup> and to actions brought directly under the Constitution.<sup>133</sup> Courts have even extended *Monell* to preclude civil rights suits against private employers for the torts of its employees which violate the Constitution. These courts find no basis to distinguish between municipal and private corporations.<sup>134</sup> This development marks a significant departure from common law respondeat superior principles.

### E. *Employment Discrimination Law*

Courts express conflicting views on the use of respondeat superior to hold employers liable for the discriminatory acts of their employees under Title VII of the Civil Rights Act.<sup>135</sup> The statute’s definition of “employer” includes agents of that employer,<sup>136</sup> and some courts have relied on this as clear evidence of congressional intent to provide for respondeat superior liability.<sup>137</sup> Some courts have also emphasized the statute’s broad humanitarian and remedial purpose.<sup>138</sup> Other courts have noted that failure to hold an employer liable for the discriminatory conduct of its employees would create a loophole in the statute.<sup>139</sup>

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130. 436 U.S. at 693 n.57.

131. 436 U.S. at 693-94.

132. *E.g.*, *DeShields v. United States Parole Commission*, 593 F.2d 354 (8th Cir. 1979); 18 U.S.C. § 4208.

133. *E.g.*, *Berry v. McLemore*, 670 F.2d 30 (5th Cir. 1982); *Jones v. City of Memphis*, 586 F.2d 622 (6th Cir. 1978), *cert. denied*, 440 U.S. 914 (1979).

134. *Powell v. Shopco Laurel Co.*, 678 F.2d 504, 506 (4th Cir. 1982); *Iskander v. Village of Forest Park*, 690 F.2d 126, 128 (7th Cir. 1982).

135. 42 U.S.C. §§ 2000e-e-17 (1982).

136. 42 U.S.C. § 2000e(b) (1982).

137. *E.g.*, *Miller v. Bank of America*, 600 F.2d 211, 213 (9th Cir. 1979).

138. *Barnes v. Costle*, 561 F.2d 983, 993 (D.C. Cir. 1977). The court did not, however, apply no-fault respondeat superior liability; it held instead that the employer would only be liable for the discriminatory practices of supervisory personnel and would be relieved of liability if supervisory personnel contravened the employer’s policies without its knowledge and if it rectified the situation when it became aware of it. *Id.* at 993. *See also* *Tomkins v. Public Serv. Electric & Gas Co.*, 568 F.2d 1044 (3d Cir. 1977).

139. *Miller v. Bank of America*, 600 F.2d at 213, (9th Cir. 1979). *Henson v. City of Dundee*, 682 F.2d 897, 910 (11th Cir. 1982).

Conversely, courts have been concerned with the harshness of holding employers liable for what may be viewed as the personal derelictions of their employees, over which the employer may have no control.<sup>140</sup> This concern has led some courts to hold that the discriminatory acts were outside the scope of employment or were wholly motivated by personal malice and therefore were not attributable to the employer.<sup>141</sup> Some courts that purport to apply respondeat superior do not do so on a no-fault basis; thus many cases state that an employer would not be liable if the employee violated company policy without the employer's knowledge and if the employer took remedial action after discovering the violation.<sup>142</sup> Even those courts that do apply classic respondeat superior theory limit its application to violations committed by supervisory personnel.<sup>143</sup>

#### F. Labor Law

Attempts by management to invalidate union elections because of the improper conduct of individuals campaigning for the union present the respondeat superior issue in the labor law area. Here also the caselaw conflicts. On the one hand, like Title VII, the National Labor Relations Act defines "employer" to include the agents of the employer,<sup>144</sup> and this can be seen as evidence that Congress intended respondeat superior to apply.<sup>145</sup> On the other hand, courts are concerned here, as with Title VII actions, with the harshness of attributing an individual's misconduct to the union, particularly where the individual may be a volunteer not readily subject to the union's control. Thus, the courts base liability upon consideration of two factors: first, the relationship between the individual and the

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140. *Henson v. City of Dundee*, 682 F.2d 897, 910 (11th Cir. 1982). In *Henson*, the court drew a distinction between cases in which the employee was threatened by loss of employment or tangible job benefits unless sexual favors were granted and cases in which the employee was subjected to a hostile work environment. In the former case, the harasser is relying on his position of power to discriminate and it is appropriate to hold the employer liable; in the latter case, his ability to harass is not necessarily enhanced by the authority conferred upon him by the employer and therefore, he is probably insulting the victims for his own reasons and by his own means. *Id.* at 910.

141. *Corne v. Bausch & Lomb, Inc.*, 390 F. Supp. 161, 163 (D. Ariz. 1975), *rev'd and remanded on other grounds*, 562 F.2d 55 (9th Cir. 1977) ("nothing more than a personal proclivity, peculiarity or mannerism").

142. *See supra* note 138.

143. *Miller v. Bank of America*, 600 F.2d at 213 (9th Cir. 1979). *See also Barnes v. Costle*, 561 F.2d at 993; (D.C. Cir. 1977) and *Tomkins v. Public Serv. Electric Gas Co.*, 568 F.2d at 1048 (3d Cir. 1977).

144. 29 U.S.C. §152(2) (1982); *see also* 29 U.S.C. § 152(13) (1982).

145. *N.L.R.B v Urban Telephone Corp.*, 499 F.2d 239, 243-44 (7th Cir. 1974).

union, and second, the action taken by the union, if any, to repudiate the wrongful conduct.<sup>146</sup> In addition, courts have considered whether the union could have foreseen the violations.<sup>147</sup> Consequently even in those decisions that purport to apply respondeat superior principles, the courts are strongly influenced by factors indicating fault on the part of the principal.

#### G. *False Claims Act*

*United States v. Ridglea State Bank*<sup>148</sup> was an action brought by the government under the False Claims Act<sup>149</sup> to recover a statutory penalty from two banks because of fraudulent loan applications approved by an employee. In refusing to impute the employee's knowledge of the fraud to the banks, the court analyzed the distinction between a civil action for compensatory damages and one for a penalty, and characterized the latter as a criminal action. In civil actions for compensatory damages, respondeat superior liability is imposed for two reasons: first, it encourages careful supervision of the employees, and second, because a third person suffered a loss, and the employer can absorb that loss more easily than his agent.<sup>150</sup> In penal actions, however, the considerations are different because potential criminal punishment serves as a deterrent to an employee who, for lack of assets, may not be deterred by the prospect of civil liability.<sup>151</sup> Further, when relief is in the form of a penalty, the policy of fair loss allocation is not present.<sup>152</sup>

#### IV. APPLICATION OF RESPONDEAT SUPERIOR AND AGENCY PRINCIPLES TO RICO

To determine the appropriateness of applying respondeat superior principles to RICO, the five factors derived from Part II's discussion will be analyzed: 1) RICO's language, 2) its legislative history, 3) its purpose, 4) sympathy for the principal, and 5) the compensation-penalty distinction.

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146. *N.L.R.B. v. Georgetown Dress Corp.*, 537 F.2d 1239, 1244; *N.L.R.B. v. Urban Telephone Corp.*, 499 F.2d 239, 243-44 (7th Cir. 1974).

147. *N.L.R.B. v. Georgetown Dress Corp.*, 537 F.2d 1239, 1244 (4th Cir. 1976) ("We cannot say [the violations] were not of the nature that a union might not expect from unsophisticated, untrained workers in a hard-fought campaign.").

148. 357 F.2d 495 (5th Cir. 1966).

149. 31 U.S.C. §§ 3729-3731 (1982).

150. *Id.* at 499.

151. *Id.*

152. *Id.*

### A. Statutory Language

Three arguments may be made that RICO's statutory language does not support respondeat superior liability. First, RICO contains no statutory provision which explicitly authorizes the application of respondeat superior principles. While this could be evidence that Congress did not intend courts to apply these principles,<sup>153</sup> the presence or absence of such language has not been particularly important in deciding the issue in the context of other statutes. Antitrust law contains no respondeat superior language, but *American Society of Mechanical Engineers v. Hydrolevel Corp.*<sup>154</sup> is a strong statement for reading respondeat superior principles into a federal statute. The CEA,<sup>155</sup> Title VII<sup>156</sup> and the National Labor Relations Act<sup>157</sup> contain provisions that support application of respondeat superior principles; nevertheless, the law in these areas is unsettled. In employment discrimination and labor relations cases, in particular, although many courts purport to apply respondeat superior, there has been a substantial transformation of the doctrine from a no-fault to a fault doctrine.<sup>158</sup>

Second, some courts have interpreted "racketeering activity" in section 1961(1)<sup>159</sup> to require active participation in the fraud on the part of the principal.<sup>160</sup> This reading of the statute is supported by the presence of the express prohibition, in section 1962(d),<sup>161</sup> against conspiring to violate the other provisions of section 1962. This suggests that Congress did not intend to make nonconspirators liable. On the other hand, RICO's "liberal construction" clause is some evidence of congressional intent that the civil remedies should be broadly applicable and not limited to criminal activity.<sup>162</sup>

Finally, the Supreme Court, in *Monell v. Department of Social*

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153. Cf. *Northwest Airlines v. Transport Workers Union*, 451 U.S. 77, 91-95 (1981); *Texas Ind. v. Radcliff Materials, Inc.*, 451 U.S. 630, 646-47 (1981), discussed *supra* note 77.

154. 456 U.S. 556 (1982). See *supra* notes 80-87 and accompanying text.

155. 7 U.S.C. §§ 1-26 (1982). See *supra* notes 121-22 and accompanying text.

156. 42 U.S.C. §§ 2000e to e-17 (1982). See *supra* note 136 and accompanying text.

157. See *supra* note 144 and accompanying text.

158. See *supra* notes 140-43, 146-47 and accompanying text.

159. 18 U.S.C. § 1961(1) (1982), amended by Comprehensive Crime Control Act of 1984, Pub. L. No. 98-473, § 1020, 98 Stat. 2143.

160. *Moss v. Morgan Stanley, Inc.*, 553 F. Supp. 1347, 1362 (S.D.N.Y.), *aff'd on other grounds*, 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 1280 (1984); *O'Brien v. Dean Witter Reynolds, Inc.*, CIV 82-1605 PHX CLH, slip. op. at 9 (D. Ariz. Mar. 26, 1984); *Dakis v. Chapman*, 574 F. Supp. 757, 760 (N.D.Cal. 1983).

161. 18 U.S.C. § 1962(d) (1982).

162. Racketeer Influenced and Corrupt Organizations Act, Pub. L. No. 91-452, § 904(a), 84 Stat. 941, 947 (1971).

*Services*,<sup>163</sup> emphasized reading the substantive provision of the statute to determine whether or not the words naturally lent themselves to respondeat superior theory. Under *Monell's* approach, a strong argument can be made that only a strained reading of the statute would support respondeat superior liability. According to section 1962(c), it is "unlawful for any person *employed by or associated with* any enterprise engaged in . . . interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt."<sup>164</sup> Thus, the sole wrongdoer under the statute is the employee-associate; it is a strained reading to extend liability to the enterprise itself. Moreover, because the primary violator is an employee or associate, and Congress was supposedly aware of respondeat superior principles, it could have expressly authorized their application under this provision if it so intended.

#### B. *Legislative History*

*Monell* also provides an example of how legislative history can support a statutory interpretation. Though the third argument in the previous section based on statutory language is the strongest, even it still may not be convincing, because it requires attributing to Congress a greater awareness of common law doctrine than perhaps is warranted. The frequent references in the legislative history to RICO's purpose of protecting legitimate businesses strengthens the argument that Congress did not intend to impose liability on such businesses.<sup>165</sup>

Under section 1962(c), three hypothetical situations are possible: 1) the enterprise may be completely tainted if all the employees are following a policy of wrongdoing directed by top management; 2) the enterprise may be the victim of the wrongdoing, where it has been infiltrated by a few employees whose illicit conduct inflicts harm on the enterprise; or 3) the enterprise may simply provide a setting for the wrongdoing, being neither an aggressor nor a victim.

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163. 436 U.S. 658 (1978). See *supra* notes 127-31 and accompanying text.

164. 18 U.S.C. § 1962(c) (1982) (emphasis added).

165. 116 CONG. REC. 953 (1970) (comments of Sen. Thurmond); *id.* at 35,327 (comments of Sen. Randall); *id.* at 35,328 (comments of Sen. Meskill); *id.* at 35,361-62 (comments of Sen. Pepper); *Organized Crime Control: Hearings on S. 30 and Related Proposals, Relating to the Control of Organized Crime in the United States*, Subcomm. No. 5 of the House Comm. on the Judiciary, 91st Cong., 2d Sess. 106 (1970) (statement of Sen. McClellan); *id.* at 157, 170 (statement of John Mitchell); *id.* at 406, 408 (statement of U.S. Chamber of Commerce).

In the first instance, the enterprise should be liable as a primary violator under either section 1962(c) or section 1962(d), the conspiracy section. Accordingly, liability under respondeat superior need not be considered. The second situation was the primary concern of Congress; there is considerable discussion in the legislative history about protecting legitimate business from the infiltration of racketeering elements.<sup>166</sup> Requiring the victimized enterprise to pay treble damages to an injured third party is antithetical to this purpose,<sup>167</sup> as this would cause additional injury to an enterprise already weakened by the corrupting employees. Indeed, it could be argued that only the enterprise has standing to sue for its injuries, although the cases to date have rejected this contention.<sup>168</sup>

Finally, the third possibility—when the enterprise has neither participated in nor been wronged by the fraud—presents the strongest case for application of traditional respondeat superior doctrine. There is nothing in the legislative history indicating Congress' consideration of any except the second situation. This fact lends additional support to the argument rejecting respondeat superior set forth in the preceding section on statutory language. On the other hand, the Supreme Court has held that the enterprises referred to in the statute include not only legitimate ones, but illegitimate ones as well.<sup>169</sup> That interpretation weakens the argument that Congress was solely concerned with protecting the enterprise.

### C. *Statutory Purposes*

If the statutory language, supplemented by examination of legislative history, decides the issue as to respondent superior's applicability, it is unnecessary to examine the legislative purposes behind the statute. Thus, for example, *Monell* contains no discussion of any policy rationale for its conclusion to reject respondeat superior. When, however, the statutory language and legislative history are silent on the question, as in *American Society of Mechanical Engineers v. Hydrolevel Corp.*,<sup>170</sup> or are inconclusive, as under the federal securities laws<sup>171</sup> and commodities laws,<sup>172</sup> it is appropriate to inquire into whether respondeat superior would further the purposes

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166. See authorities cited *supra* note 165.

167. See *Parnes v. Heinold Commodities, Inc.*, 548 F. Supp. 20, 23-24 (N.D. Ill. 1982).

168. See *Dakis v. Chapman*, 574 F. Supp. 757, 760 (N.D. Cal. 1983).

169. *United States v. Turkette*, 452 U.S. 576, 580-93 (1981).

170. 456 U.S. 556 (1982). See *supra* notes 80-83 and accompanying text.

171. See *supra* note 91 and accompanying text.

172. See *supra* notes 124-25 and accompanying text.

of the legislation.

RICO's legislative history repeatedly recites that the statute's purpose is to stop the infiltration of racketeers into legitimate business.<sup>173</sup> The primary beneficiary of the statute is the general public, who must bear the adverse effects of the infiltration.<sup>174</sup> An additional beneficiary is the invaded business itself, which is cleansed of the corrupting influence.<sup>175</sup> A third beneficiary is the private plaintiff under section 1964(c).

There is a conflict between the interests of the first two beneficiaries and the third. Congress probably did not recognize this conflict, perhaps because of the late addition of the private remedy.<sup>176</sup> The general public and legitimate businesses are best served by placing liability for treble damages solely on the RICO violator; he will be financially ruined, without injury to the enterprise, which has, by hypothesis, already been weakened by the corrupting element and would be further weakened by imposition of liability. Conversely, a private plaintiff's interests are probably best served by imposing respondeat superior liability on the firm, because the chances of collection presumably are greater. Because loss distribution is the principal rationale for respondeat superior, it is important to determine whether or not it is compatible with the policies of RICO. The purpose behind RICO is to destroy the racketeering element that has infiltrated legitimate business.<sup>177</sup> This purpose is antithetical to a philosophy of loss-spreading, and suggests that injuries occasioned by RICO violators should not be viewed as ordinary business losses to be spread over society as a whole. Certainly, the worker-protection

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173. *E.g.*, 116 CONG. REC. 591 (1970) (comments of Sen. McClellan); *id.* at 602 (comments of Sen. Hruska); *id.* at 603 (comments of Sen. Yarborough); *id.* at 607 (comments of Sen. Byrd); *id.* at 854; *id.* at 36,296 (comments of Sen. Dole); *id.* at 35,196 (comments of Sen. Celler); *id.* at 35,201 (comments by Rep. Poff); *id.* at 35,295 (comments by Rep. Poff); *id.* at 35,304 (comments of Sen. Railsbeck); *id.* at 6709 (comments of Rep. Poff).

174. *Id.* at 591 (comments of Sen. McClellan); *id.* at 602-603 (comments of Sen. Hruska); *id.* at 607 (comments of Sen. Byrd); *id.* at 820 (comments of Rep. Scott); *id.* at 36,396 (comments of Rep. Fannin); *id.* at 35,201 (comments of Rep. Poff); *id.* at 35,328 (comments of Rep. Meskill).

175. *Id.* at 953 (comments of Sen. Thurmond); *id.* at 35,295 (comments of Rep. Poff); *id.* at 35,327 (comments of Rep. Randell).

176. The version of the bill passed by the Senate on Jan. 23, 1970 did not contain a private remedy. Section 1964(c) was added in the amended version of the bill passed by the House on Oct. 7, 1970. *See id.* at 35,227. The Senate concurred in the House amendment without discussion on Oct. 12, 1970. *Id.* at 36,296.

177. *Id.* at 591 (comments of Sen. McClellan); *id.* at 602-03 (comments of Sen. Hruska); *id.* at 607 (comments of Sen. Byrd); *id.* at 36,296 (comments of Sen. Dole); *id.* at 35,295 (comments of Rep. Poff); *id.* at 35,304. (Sen. Railsbeck, commenting on special message sent by Pres. Nixon to Congress on organized crime (April 23, 1969)).

aspect of respondeat superior<sup>178</sup> is inapposite here, as these workers, by definition, are racketeers.

On the other hand, such a conclusion may seem objectionable because, if the RICO violator cannot be sued or cannot pay, the loss falls upon the third party. There are two answers to this objection. First, the compensatory aspect of the statute seems secondary to the punitive aspect, as discussed below.<sup>179</sup> Second, in the case of churning and suitability claims, the victim may pursue other remedies that will compensate him for his injury under securities or commodities laws, where respondeat superior may be available.<sup>180</sup> Thus, he may be able to obtain compensation for his injuries; what he will lose is RICO's treble damages award and attorney's fees.<sup>181</sup>

As to the deterrence rationale for respondeat superior—an important consideration in the securities and commodities laws—it can be argued that liability under respondeat superior would provide a greater incentive to deter racketeering activity within an organization. Nothing in the legislative history, however, suggests that Congress considered strengthening business' incentive to resist employees' racketeering activities. Congress may well have thought that no additional encouragement was needed because legitimate businesses would naturally resist invasion by racketeers. Again, when the underlying predicate offenses are violations of the securities and commodities laws, there are already incentives to encourage brokerage firms to supervise their employees.<sup>182</sup>

#### D. *Sympathy for the Firm*

As noted above, the few opinions dealing with respondeat superior liability in the RICO securities fraud actions express sympathy for a firm that has liability "thrust upon it" because of the miscon-

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178. See *supra* note 50 and accompanying text.

179. See *infra* notes 186-93 and accompanying text.

180. See *supra* notes 88-126 and accompanying text.

181. Note, however, that a plaintiff may be able to recover punitive damages under state law. See, e.g., *Malandris v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 703 F.2d 1152 (10th Cir.), *cert. denied*, 104 S. Ct. 92 (1983).

182. Application of respondeat superior theory to impose liability on firms for their employees' securities and commodities violations provides an incentive for firms to supervise their employees. Some courts interpret § 20(a) of the Exchange Act as imposing a duty of supervision on securities firms in order to establish the good faith defense of that provision. See, e.g., *Hecht v. Harris, Upham & Co.*, 283 F. Supp. 417, 438-39 (N.D. Cal. 1968), *modified on other grounds*, 430 F.2d 1202 (9th Cir. 1970). The SEC can sanction firms if they fail to reasonably supervise their employees; reasonable supervision is met if the firm has in place procedures to prevent and detect violations. Exchange Act § 15(b)(4)(E) (1934) (codified at 15 U.S.C. § 780 (1982)).

duct of low-level employees.<sup>183</sup> While such expressions of concern seem to contradict modern respondeat superior theory, they prevail in the cases discussed above involving employment discrimination<sup>184</sup> and labor relations.<sup>185</sup> These concerns also find support in RICO's legislative history, discussed above, with its emphasis on protecting legitimate business.

#### E. *Compensation v. Penalty*

*United States v. Ridglea State Bank*<sup>186</sup> developed the different considerations in compensatory and penal actions. In the former category, the loss distribution and deterrence rationales for respondeat superior warrant its application, while in the latter category, these rationales are absent. The issue then becomes whether RICO is primarily a penal or a compensatory statute. The more it resembles a penal statute, the less appropriate respondeat superior appears to be.

The original and predominant motivation for the statute was to enable the government to prosecute organized crime more effectively. RICO was only one article in the Organized Crime Control Act of 1970, which was intended to be a comprehensive weapon in the war against organized crime.<sup>187</sup> Indeed, one controversial provision in the law was the revival of the penalty of criminal forfeiture.<sup>188</sup>

On the other hand, the Senate Report accompanying the Organized Crime Control Act of 1970 emphasized that the RICO civil provisions were remedial and not penal.<sup>189</sup> This characterization is supported by the statute's "liberal construction" clause.<sup>190</sup> The later addition of the treble damages provision, it can be argued, does not affect this classification of the statute. The legislative history repeatedly refers to the civil remedies of the antitrust laws, and the treble damages provision was modeled after that contained in the antitrust

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183. See, e.g., *Parnes v. Heinold Commodities, Inc.*, 548 F. Supp. 20, 24 n.9 (N.D. Ill. 1982).

184. See *supra* note 140 and accompanying text.

185. See *supra* notes 146-47 and accompanying text.

186. 357 F.2d 495 (5th Cir. 1966). See *supra* notes 148-52 and accompanying text.

187. Courts have characterized RICO as primarily a criminal statute. E.g., *Sevill Industrial Machinery Corp. v. Southmost Machinery Corp.*, 742 F.2d 786, 789 (3d Cir. 1984), *cert. denied*, 105 S. Ct. 1179 (1985).

188. Section 1963(c).

189. S. Rep. 91-617 (91st Cong., 1st Sess.) 81-82 (1969). The version of RICO enacted by the Senate did not contain any private remedies. ". . . there is no intent to visit punishment on any individual; the purpose is civil. Punishment as such is limited to the criminal remedies. . . . Title IX, it must be again emphasized, is remedial rather than penal."

190. Racketeer Influenced and Corrupt Organizations Act, Pub. L. No. 91-452, § 904(a), 84 Stat. 941, 947 (1971).

law. The Supreme Court, moreover, in *Hydrolevel*, rejected the argument that the antitrust treble damages remedy should be characterized as a penal statute.<sup>191</sup>

While the Senate Report thus provides the best support for the position that RICO should be viewed as remedial legislation, it should be noted that the report solely addressed the civil remedies available to the government, for the purpose of reforming the corrupted organization.<sup>192</sup> The conflict between this purpose and the interests of the private plaintiff has already been noted.<sup>193</sup>

Thus, on balance, the loss distribution and deterrence rationales enunciated in *United States v. Ridglea State Bank* are inappropriate considerations in the RICO context; and the statute, in fact, is better classified as penal for resolution of the respondeat superior issue.

## V. CONCLUSION

Part IV has analyzed the specific provisions of RICO in light of the relevant factors outlined in Part III. While the statutory language arguments are inconclusive, they support an argument rejecting respondeat superior. Examination of legislative history, while also not conclusive, provides greater support for rejection. An analysis of the legislative purpose, viewed in the light of Congress's specific concerns and the general policies of respondeat superior, provide the strongest arguments for rejection. Finally, sentiments of sympathy for the firm find support in the legislative history, as does the distinction between compensatory and penal actions.

Therefore, in the typical RICO civil action brought by a defrauded customer, alleging churning and suitability violations, the only appropriate defendant is the registered representative who defrauded the customer, and not the securities firm itself. Judicial rejection of respondeat superior in these circumstances should reduce the tremendous number of RICO claims currently naming firms as defendants and is consistent with RICO's statutory language and underlying purposes. Accordingly, the perception that amendment of RICO to restrict its application is necessary to reduce the number of civil RICO claims brought against securities firms and others is faulty, because judicial recognition of the inapplicability of respondeat superior principles would result in dismissal of many of these claims.

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191. See *supra* notes 85-86 and accompanying text.

192. S. Rep. *supra* note 189, at 81-82.

193. See *supra* notes 176-78.