RICO Claims in Noncompete Cases -- A Growing Trend?

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So the former employee who walked out the door with your company's "secret recipe" is not in the mob. Does that mean the Racketeer Influenced and Corrupt Organizations Act ("RICO") does not apply? A growing number of companies contend that it does. Recently, attorney search firm Major, Lindsey & Africa filed suit against a former employee alleging RICO violations based on accusations that the former employee took confidential information. (To read more about that case, click here.) And yesterday, Pennsylvania-based Venturi Technologies, Inc. filed a RICO claim against two former employees and the companies they created. Venturi contends the former employees formed and operated competing companies prior to resigning and surreptitiously diverted business to these entities. (For a copy of the Venturi complaint, click on the pdf file at the bottom of this post.) Does RICO apply?

Although the original intent of RICO was to enable prosecutors to better fight organized crime, its generically written and broadly construed language renders it a potential – albeit underutilized – weapon in employee defection litigation.

Section 1964(c) of RICO provides that "[a]ny person injured in his business or property by reason of a violation of [RICO] may sue therefor in any appropriate United States district court and shall recover three fold the damages he sustains and the cost of the suit, including a reasonable attorney's fee . . . . " 18 U.S.C. § 1964(c). This is a powerful piece of legislation. To state the obvious advantages for plaintiffs: federal question jurisdiction; treble damages; and attorney's fees and costs. Among the federal statutes that arguably could be relied upon to sue former employees, no others provide such generous remedies.

To establish a claim under RICO, a plaintiff must show that it was injured by the defendant's (1) conduct (2) of an enterprise (3) through a pattern of racketeering activity. See Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 496 (1985). To establish the first element, the defendant's conduct must constitute one of the predicate acts enumerated in Section 1961 of the statute. In the employee defection context, the most frequently relied upon predicate acts are mail fraud and wire fraud, both of which have been held applicable to the theft of trade secrets and confidential business information by the United States Supreme Court. See Carpenter v. United States, 484 U.S. 19, 26 (1987). Thus, an employee who uses the mail, telephone, or internet to misappropriate trade secrets, or who uses such mediums to make fraudulent misrepresentations to his or her employer's customers to induce them to change their allegiance, can be argued to have engaged in conduct that

satisfies the first element of a RICO claim. See, e.g., Formax, Inc. v. Hostert, 841 F.2d 388, 390 (Fed. Cir. 1988) ("Activities such as those alleged in the instant case – misappropriation of trade secrets – fall within the definition of property and fraud under the mail and wire fraud statutes and thus can fulfill some elements of a RICO violation.")

The second element requires the existence of an "enterprise," which the statute broadly defines as "any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity." 18 U.S.C. § 1961(4). An enterprise must be distinct from a RICO defendant, but the Supreme Court has held that a defendant's employer is sufficiently distinct from the defendant to satisfy the requirement. See Cedric Kushner Promotions, Ltd. v. King, 533 U.S. 158, 162 (2001). Thus, a former employee's new employer or newly created company might constitute an enterprise for purposes of the Act. Moreover, because an enterprise is merely the vehicle through which a defendant perpetrates racketeering activity, a plaintiff employer may even be an enterprise.

The most difficult element for a RICO plaintiff to establish is the "pattern of racketeering activity." The phrase is specifically defined in the statute as requiring "at least two acts of racketeering activity, one of which occurred after the effective date of [RICO] and the last of which occurred within ten years . . . after the commission of a prior act of racketeering activity[.]" 18 U.S.C. § 1961(5). The Supreme Court, however, has interpreted "pattern" to mean more than its seemingly straightforward statutory definition.

The Supreme Court has held that to establish a pattern of racketeering activity, "a plaintiff or prosecutor must show that the racketeering predicates are related, and that they amount to or pose a threat of continued criminal activity." H.J. Inc. v. Northwestern Bell Tel. Co., 492 U.S. 229, 239 (1989). According to the Court, predicate acts are "related" if they "have the same or similar purposes, results, participants, victims, or methods of commission, or otherwise are interrelated by distinguishing characteristics and are not isolated events." Id. at 240. This aspect of the "pattern" definition can easily be argued in the employee defection context.

Suppose an employee emails a confidential customer list to his personal e-mail account to help him start his competing business. Suppose further that two months later, the employee begins contacting the customers on the list by telephone and making fraudulent misrepresentations to entice them to leave the employer and join him at his new business. Those two acts have the same purpose: to gain an unfair competitive advantage. They also involve the same participant (the employee) and the same victim (the employer). Thus, the predicate acts are arguably "related" under the Supreme Court's interpretation of the Act.

The second prong of the "pattern" definition – the "threat of continued criminal activity" – is not as easy to establish. Under the Supreme Court's definition, continuity can refer to either a closed period of repeated conduct, in which the predicate acts occur over a substantial period of time (generally recognized to be at least two years), or an open period of repeated conduct, in which there is past

recognized to be at least two years), or an open period of repeated conduct, in which there is past criminal conduct coupled with a threat of future criminal conduct. H.J., Inc., 492 U.S. at 241-42. Because few employees even attempt, much less get away with, pilfering trade secrets over a two-year period, most employee defection cases involve open periods of racketeering. That is, the employee has stolen trade secrets shortly before or contemporaneously with his or her departure with the intention of starting a competing business or leveraging a better offer of employment from a competitor. It is the anticipated future criminal act of using or disclosing the unlawfully acquired information that may render the employee's racketeering in an open period.

As a final matter, Rule 9(b) of the Federal Rules of Civil Procedure can be a weary trap for the unsuspecting RICO plaintiff. Rule 9(b) requires that "in alleging fraud . . . a party must state with particularity the circumstances constituting fraud . . . ." Rule 9(b), Fed. R. Civ. P. Because the predicate acts upon which a RICO claim in the employee defection context are likely to be based involve fraud as an essential element, a plaintiff is well-advised to allege the who, what, when, why, where, and how involved to avoid a motion to dismiss for failure to state a claim. This is particularly true given the Supreme Court's recent amplification of Rule 9(b) in Ashcroft v. Iqbal, 129 S. Ct. 1937 (2009), and Bell-Atlantic Corp. v. Twombly, 550 U.S. 544 (2007).

Given the recent noncompete cases asserting RICO claims against former employees, it appears some companies view a RICO claim as a fitting complement to more traditional causes of action such as misappropriation of trade secrets and breach of the duty of loyalty. Indeed, with the ability to sue in federal court and recover treble damages, as well as attorney's fees and costs, it may be the preferred claim from a plaintiff's perspective.

Venturi Complaint.pdf (93.13 kb)

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