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Case Study: Cedeno V. Castillo

Law360, New York (February 21, 2012, 1:42 PM ET) -- The U.S. Supreme Court's 2010 decision in Morrison v. National Australia Bank Ltd. created a sea change in private securities litigation by sharply limiting the extraterritorial application of the securities laws while employing language suggesting skepticism of extraterritoriality more generally.

Since then, the lower federal courts have been reevaluating the extraterritorial applicability of other statutory causes of action, including Racketeer Influenced and Corrupt Organizations cases.[1] The Second Circuit's recent decision in Eligio Cedeno v. Castillo, 10-3861-cv (2d Cir. Jan. 24, 2012), continues the post-Morrison trend of limiting the extraterritorial reach of statutes creating private rights of action.

In Morrison v. NAB, the Supreme Court concluded that, as a general rule of statutory construction, extraterritoriality may not be inferred in the absence of clear congressional intent. Section 10(b) of the Exchange Act contains no suggestion that Congress intended it to have extraterritorial reach; therefore, the court reasoned, it does not. The RICO statute, 18 U.S.C. § 1961 et seq., like Section 10(b), is silent as to its extraterritorial application.

But, while Morrison took a "transactional" approach, focusing on the location of a discrete purchase or sale, RICO claims inherently involve something more pervasive than individual, identifiable transactions: The statute defines a "pattern of racketeering activity" perpetrated by a criminal enterprise as requiring "at least two acts of racketeering activity," some of which may occur in the United States.

This was not the first time the Second Circuit had considered RICO in light of Morrison. In Norex Petrol. Ltd. v. Access Indus. Inc.,[2] which involved a RICO claim by a foreign shareholder of a foreign company against a foreign defendant, the Second Circuit asked whether a substantial portion of the alleged criminal racketeering activities occurred within the United States, and concluded that extraterritorial application of RICO could not be supported by the "slim" domestic contacts alleged.

Cedeno v. Intech Group Inc.,[3] presented the Second Circuit with another opportunity to define the outer boundaries of RICO's application. The defendants, who were Venezuelan officials and their political allies, had allegedly engaged in an extortion and money laundering scheme that took place abroad, but relied on New York-based banks — not named as parties to the litigation — to hold and conceal hundreds of millions of dollars of fraudulently obtained profits.

In the district court, U.S. District Judge Jed S. Rakoff, extending the logic of Morrison, opined that RICO "is focused on how a pattern of racketeering affects an enterprise … nowhere does the statute evidence any concern with foreign enterprises, let alone a concern sufficiently clear to overcome the presumption against extraterritoriality." Judge Rakoff's opinion suggests that no matter the U.S. conduct or connections, a foreign "enterprise" cannot trigger the civil RICO statute.

On appeal to the Second Circuit, Cedeno raised three main arguments: (1) because his claim alleged conduct that took place in the United States, it fit within the scope of RICO; (2) even if his complaint did not allege a domestic RICO violation, it should have been allowable based upon the underlying predicate offenses of money laundering and extortion, which do apply extraterritorially; and (3) the district court should have permitted his request to replead domestic contacts with greater particularity.

On Jan. 24, 2012, the Second Circuit affirmed the district court's holding in a summary order, rejecting all of Cedeno's arguments. First, the court classified the criminal enterprise alleged by Cedeno, which consisted of various components of the Venezuelan government, as "patently foreign" under any standard for determining locus.[4]

While the court acknowledged that the absolute contours of the standard for extraterritoriality had not been sharply defined, the complaint in Cedeno "fail[ed] to allege that the domestic predicate acts proximately caused [Cedeno's] injuries." It so clearly fell outside of the scope of allowable RICO actions that it was "unnecessary for [the court] to decide what constitutes the 'object' of RICOS's 'solicitude.'"

The Second Circuit did not go as far as to wholly endorse the district court's reasoning that would apply RICO only to domestic enterprises: "Regardless of whether RICO is found to focus on domestic enterprises, as the district court held, or on patterns of racketeering, as [Cedeno] contends it should be, the complaint here alleges inadequate conduct in the United States to state a domestic RICO claim."

Next, the Second Circuit rejected Cedeno's predicate offense argument because its holding in Norex foreclosed the applicability of RICO based on predicate offenses that occurred abroad. Finally, the Second Circuit supported the district court's denial of Cedeno's request to amend his complaint because he had been on notice for a very long time — even prior to Morrison — that some of the defendants had moved to dismiss based upon a lack of extraterritorial application. Cedeno would be free to file a new claim if defendants had committed additional RICO violations, noted the court, but amending the complaint in this action would not be proper.

After Cedeno and Norex, it seems clear there are no circumstances under which RICO will apply to conduct occurring almost entirely outside of the United States, regardless of its U.S. effects. Judge Rakoff's order suggests a potentially broader rule, that the corrupt enterprise must be a U.S. enterprise. The nature of the summary affirmance, however, leaves open the possibility that the Second Circuit will adopt a different rule in the future.

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[1] For more information, see our legal update, “Extraterritorial Jurisdiction: Morrison’s Reasoning Limits RICO Claims As Well.”

[2] 631 F.3d 29, 31 (2d Cir. 2010).

[3] 733 F. Supp. 2d 471 (S.D.N.Y. 2010).

[4] Eligio Cedeno v. Castillo, 10-3861-cv (2d Cir. Jan. 24, 2012) (summary order).