

Is Plaintiff's Own Reliance Required for Mail Fraud-Based RICO?

by

Robert A. Schwinger*

The Supreme Court recently granted certiorari in *Bridge v. Phoenix Bond & Indemnity Co.*,¹ an appeal from a Seventh Circuit decision,² to resolve a circuit split on “[w]hether reliance is a required element of a RICO claim predicated on mail fraud and, if it is, whether that reliance must be by the plaintiff.”³ Must the RICO plaintiff itself have relied on the fraudulent communications upon which the claim is based? Or is it enough that someone else relied on these communications, and that this led to the plaintiff’s injury? Or perhaps is it not even necessary to show anyone’s reliance at all?

The issue posed by *Bridge* has divided the circuits, and while it has come before the Supreme Court twice in recent terms, it has never been formally resolved. In the 2005 term, the issue was briefed in *Bank of China v. NBM L.L.C.*, but the case settled and was dismissed before argument.⁴ The same issue arose again the next term in *Anza v. Ideal Steel Supply Corp.*, where the Court did issue a decision,⁵ but it disposed of the case on general proximate cause grounds without having to reach the more specific question of reliance in regard to mail fraud.

Bridge, which should be decided by the end of the Court’s term this spring, thus appears poised to finally resolve this issue. The Court’s decision will set the stage regarding just how expansively RICO can be used in typical commercial contexts.

Robert A. Schwinger is a partner in the commercial litigation group at Chadbourne & Park LLP. He is reachable at 212-408-5364 or rschwinger@chadbourne.com. Reprinted with permission from the March 6, 2008 edition of the New York Law Journal. © 2008 ALM Properties, Inc. All rights reserved. Further duplication without permission is prohibited.

Background: The Basics of Civil RICO Liability

The RICO statute⁶ defines a laundry list of crimes as acts of “racketeering activity.”⁷ Predicate acts of racketeering activity that are of a sufficient nature, number and duration will be deemed to amount to a “pattern of racketeering activity.”⁸ It is unlawful to conduct or to participate in the conduct of an “enterprise” (which could be a business or a criminal organization)⁹ through a pattern of racketeering activity.¹⁰ A person injured in his business or property “by reason of” such a violation may bring a civil suit against the wrongdoer for treble damages and attorneys’ fees.¹¹

The compensable injury in a such a civil suit consists of “the harm caused by predicate acts [which] constitute [the] pattern.”¹² The “by reason of” language in RICO’s private right of action requires a showing “that the defendant’s violation not only was a ‘but for’ cause of his injury, but was the proximate cause as well.”¹³

In civil RICO contexts, the predicate acts alleged almost always consist predominantly, if not entirely, of mail and wire fraud. Under the statutes which define those crimes, the offense consists of using the mails (or interstate/foreign wire communication) in furtherance of a “scheme or artifice to defraud.”¹⁴ There is no requirement that the fraud be “completed” or that the scheme to defraud succeed.¹⁵ Moreover, the communication in question need not be made directly by the perpetrator to the intended victim, and need not be fraudulent in and of itself, so long as it furthers the overall scheme to defraud.¹⁶

The Alleged Fraud in *Bridge*

Bridge arose from alleged fraud by bidders in tax lien auctions in Cook County, Illinois.¹⁷ County rules provided that if the number of bidders willing to accept the minimum amount exceeded the number of available liens, they would be distributed by lot. To avoid gamesmanship and achieve distributional equity, bidders were forbidden from submitting multiple bids, including under other names or through related parties, and had to submit an affidavit to that effect. The plaintiffs in *Bridge* alleged that the defendants violated these rules, thus unfairly diminishing the number of parcels on which the plaintiffs were the winning bidders.

Because the mails were used to submit the false affidavits, and/or to notify owners that their tax liens had been sold to the winning bidder, the plaintiffs sued the defendants under RICO for damages they allegedly sustained from this pattern of mail fraud activity.¹⁸ The defendants moved to dismiss, arguing that the plaintiffs had not themselves relied on the cited mailings and thus could not have been injured by them. The district court agreed with the defendants and dismissed for lack of standing, but the Seventh Circuit reversed.

The Seventh Circuit held that the reduction in the number of tax liens plaintiffs could take away from the auction was sufficient to amount to “injury in fact” for standing purposes, and that the real issue was whether the necessary proximate cause link existed between the alleged RICO violation and the plaintiffs’ injury.¹⁹ The defendants argued that it was the County, not the plaintiffs, who was the victim of the mail fraud, but the Seventh Circuit disagreed. It stated the scheme did not injure the County financially but only other bidders like the plaintiffs, and that the mail fraud statute makes the scheme, rather than the particular false statements, the crime.²⁰ The court concluded that the plaintiffs’ claimed injuries were direct, not derivative of someone else’s injury, and thus proximate cause was present, regardless of any contention that the plaintiffs were not in the “zone of interest” of the mail fraud statute in this situation.²¹ The Seventh Circuit noted that while the circuits were split, the majority had held that the RICO plaintiff need not itself have relied on the allegedly violative mailing.²²

Anza Revisited and Perhaps Distinguished

Bridge brings up many of the same issues that the Supreme Court addressed two terms ago in *Anza v. Ideal Steel Supply Corp.*,²³ where it held that one competitor could not bring a RICO complaint against another based upon a sales tax fraud that the other competitor perpetrated against the government. That fraud allegedly lowered the other competitor’s costs and thus enabled it to lower its prices because it did not face the cost pressure of complying with sales tax laws. However, the Supreme Court held the claim barred on proximate cause grounds because of the difficulty of ascertaining to what extent the lowered prices were the result of illicit sales tax fraud versus legitimate price competition.²⁴ *Anza* seemingly short-circuited the possibility that honest businesses could obtain meaningful relief against dishonest competitors in such situations under the RICO statute.²⁵ The grant of certiorari in *Bridge* poses the question of whether the Court will reaffirm and solidify the limits it placed on RICO in *Anza*, or is prepared to limit and distinguish *Anza* in a way that may further expand RICO’s use as a tool in business litigation.

The Seventh Circuit viewed *Anza* as having presented a special situation where there was a more immediate victim of the fraud (the government who was cheated out of taxes) and it was too difficult to determine whether the wrongdoer’s lowered prices represented as pass-along of the fruits of the crime or just legitimate price competition.²⁶ Those special circumstances are not present in *Bridge*, forcing the Supreme Court to now confront whether a plaintiff must itself be the victim of the fraud and/or have relied on the mailings to have a mail-fraud-based RICO claim.

Is Plaintiff’s Reliance the Only Way To Show Proximate Cause?

In unsuccessfully opposing the defendants’ petition for certiorari, the plaintiffs argued that there is nothing in the statutory language of RICO or the mail fraud statute to require such reliance. They contended that reliance was relevant only insofar as it was a possible a means of showing a proximate causal link. They argued such a link could be shown either (1) where the plaintiff itself reasonably relied on the fraudulent statements, or (2) where the

statements were made to and reasonably relied upon by someone else, when the plaintiff had been the intended victim and was injured as a result of the third person's reliance.²⁷ In fact, they argued that when these two fact scenarios were distinguished, the claimed circuit split was in fact illusory,²⁸ and that it was only when neither situation was present that the claim was dismissed.²⁹

The plaintiffs further noted that the Solicitor General's amicus brief in the abortive *Bank of China* case two terms ago took the view that fraud-based civil RICO claims "require reliance by someone . . . but not necessarily reliance *by the plaintiff*."³⁰ However, an amicus filing against the Seventh Circuit's holding in *Bridge* argued that allowing RICO claims to proceed without the plaintiff's own reliance would open the door to easy class certification of such claims, with the attendant drain that such costly litigation places on the national economy, and that a reliance-based limitation on mail fraud-based RICO claims was thus needed.³¹

The Broader Issue Before the Court

Ultimately, the issue in *Bridge* appears whether the Court can easily define acceptable limits of remoteness and directness in a RICO plaintiff's injury when the claim is based on mail fraud. The compensable injury in civil RICO claims is that which is caused by the predicate acts.³² Contrary to the Seventh Circuit's rather blithe assertion in *Bridge*,³³ the offense in a mail fraud case has long been understood to consist not of the scheme itself but rather of the actual mailings—which is why multiple mailings in furtherance of a single scheme

are deemed to yield multiple indictable acts of mail fraud.³⁴ When those mailings directly affect only a third person, and it is only that third person's subsequent conduct in response which then touches the plaintiff, will that be deemed too indirect or remote to satisfy the requirements of proximate cause—and indeed so clearly so that the case can be dismissed right at the pleading stage?

While the Seventh Circuit in *Bridge* correctly noted that the Supreme Court in *Anza* had cited the problems of untangling how the claimed damages derived from the defendants' alleged fraud versus other nonactionable factors as a basis for rejecting the RICO claim, the *Anza* court also cited concerns about "attenuated connection[s]" under RICO's "directness requirement[]." ³⁵ The Court may well still have more to say on those issues.

In recent years the Supreme Court — and particularly now the Roberts Court — has repeatedly expressed concerns over the costs of commercial litigation (and class actions specifically) that can arise from leniently-defined causes of action that allow weak but opportunistically-pled claims to proceed.³⁶ Given this concern, it remains to be seen whether the Supreme Court views *Bridge* as the next area where potentially abusive litigation needs to be constrained. The Court may take *Bridge* as an opportunity to cabin a broad view of RICO causation that in the commercial context which, if left unchecked, could open the doors for increased treble-damages civil RICO litigation, and thus threaten significant costs and settlement pressures on businesses whose only "crime" may be nothing more than an inability to obtain early dismissal at the pleading stage.

Notes

¹ No. 07-210, cert. granted (U.S. Jan. 4, 2008).

² *Phoenix Bond & Indem. Co. v. Bridge*, 477 F.3d 928 (7th Cir. 2007).

³ See note 1, *supra*.

⁴ *Bank of China v. NBM L.L.C.*, No. 03-1559, cert. granted, 545 U.S. 1138, and cert. dismissed by stipulation, 546 U.S. 1026 (2005).

⁵ 126 S. Ct. 1991 (2006).

⁶ *Racketeer Influenced and Corrupt Organizations Act*, 18 U.S.C. §§ 1961-68.

⁷ *Id.* § 1961(1).

⁸ *Id.* § 1961(5); see generally *H.J., Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 236-43 (1989).

⁹ See 18 U.S.C. § 1961(4); *U.S. v. Turkette*, 452 U.S. 576, 583 (1981).

- ¹⁰ 18 U.S.C. § 1962(c).
- ¹¹ *Id.* § 1964(c).
- ¹² *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 497 (1985).
- ¹³ *Holmes v. Sec. Investor Prot. Corp.*, 503 U.S. 258, 268 (1992).
- ¹⁴ 18 U.S.C. §§ 1341, 1343.
- ¹⁵ *Neder v. U.S.*, 527 U.S. 1, 25 (1999).
- ¹⁶ See, e.g., *Schmuck v. U.S.*, 489 U.S. 705, 714-15 (1989); *Pereira v. U.S.*, 347 U.S. 1, 8-9 (1954); 2 L. Sand, et al., *Modern Federal Jury Instructions—Criminal*, Instr. 44-6 (Matthew Bender 2007 rev.)
- ¹⁷ In a tax lien auction, a state or local government auctions off to private parties the right to enforce the government's tax lien against parcels of real property, including the right to collect penalties from the delinquent owner. In return for this right, the winning bidder pays the delinquent taxes to the government. See 477 F.3d at 929.
- ¹⁸ See *id.* at 930.
- ¹⁹ *Id.*
- ²⁰ *Id.* at 932.
- ²¹ *Id.* at 931-33.
- ²² *Id.* at 932-33. The Seventh Circuit identified *Mid Atlantic Telecom, Inc. v. Long Distance Services, Inc.*, 18 F.3d 260, 263-64 (4th Cir. 1994), *Systems Management, Inc. v. Loisel*, 303 F.3d 100, 103-04 (1st Cir. 2002), and *Ideal Steel Supply Corp. v. Anza*, 373 F.3d 251, 263 (2d Cir. 2004), *rev'd* on other grounds, 126 S. Ct. 1991 (2006), as not requiring such reliance, with *Vandenbroeck v. CommonPoint Mortgage Co.*, 210 F.3d 696, 701 (6th Cir. 2000) and *Sikes v. Teleline, Inc.* 281 F.3d 1350, 1360-61 (11th Cir. 2002), taking the contrary point of view.
- ²³ 126 S. Ct. 1991 (2006).
- ²⁴ *Id.* at 1996-97.
- ²⁵ See R. Schwinger, *Honest Competitors Catch No Break Under RICO*, *Metropolitan Corp. Counsel*, Aug. 2006) at 17.
- ²⁶ 477 F.3d at 930-31.
- ²⁷ Brief of Respondents in Opposition to Petition for Writ of Certiorari at 22-30, in *Sabre Group, LLC v. Phoenix Bond & Indem. Co.*, No. 07-210 (U.S. Nov. 16, 2007), 2007 WL 4132891.
- ²⁸ *Id.* at 12-22.
- ²⁹ The plaintiffs also noted that the Sixth Circuit has recently questioned its prior holding on this issue requiring such reliance but adhering to the precedent on stare decision grounds. *Id.* at 18-20 (discussing *Brown v. Cassens Transp. Co.*, 492 F.3d 640, 644-46 (6th Cir. 2007)).
- ³⁰ Brief for the United States as Amicus Curiae Supporting Respondents at 21, *Bank of China v. NBM L.L.C.*, No. 03-1559 (U.S. Oct. 31, 2005), 2005 WL 2875061.
- ³¹ Brief of McKesson Corp. as Amicus Curiae in Support of Petitioners' Petition for Writ of Certiorari at 13-15, *Sabre Group, LLC v. Phoenix Bond & Indem. Co.*, No. 07-210 (U.S. Nov. 16, 2007), 2007 WL 4132890.
- ³² See note 12, *supra*.
- ³³ See note 20, *supra*.
- ³⁴ See, e.g., *In re Henry*, 123 U.S. 372, 374 (1887); *Badders v. U.S.* 240 U.S. 391, 393-94 (1916). Indeed, the Seventh Circuit's own authority is to the same effect. See, e.g., *U.S. v. Aldridge*, 484 F.2d 655, 660 (7th Cir. 1973).
- ³⁵ 126 S. Ct. at 1997 (citing *Holmes*, 503 U.S. at 269-73).
- ³⁶ See, e.g., *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 347 (2005), *Bell Atl. Corp. v. Twombly*, 127 S. Ct. 1955, 1966-67 (2007); *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2508 (2007); *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705, 2718 (2007); *Stoneridge Inv. Partners v. Scientific-Atlanta, Inc.*, No. 06-43, slip op. at 12-13, 2008 WL 123801, at *8 (U.S. Jan. 15, 2008).