Guest commentary

Supreme Court clarifies role of reliance in civil RICO claims predicated on mail fraud

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In Bridge v. Phoenix Bond & Indemnity Co., No. 07-210 (U.S. 06/09/08), the Supreme Court held that a plaintiff asserting a RICO claim predicated on mail fraud need not show that it relied on the defendant’s alleged misrepresentations.

Despite this seemingly broad holding, a practitioner bringing a RICO claim based on mail or wire fraud should pay careful attention to the court’s dicta noting that a showing of reliance on the defendant’s misrepresentations may be necessary to establish proximate cause and ultimately prevail at trial. Also, the decision does not change the requirement that to have standing, the plaintiff must be the party most directly injured by the fraud, pursuant to Anza v. Ideal Steel Supply Corp., 547 U.S. 451 (2006).

In Phoenix Bond, the parties were regular bidders in tax lien auctions in Cook County, Ill. Because the auction process often resulted in multiple tie bids, the county allocated properties on a rotational basis to ensure a fair distribution among the bidders. In an effort to avoid having one party amass a disproportionate share of tax liens, the county adopted the “Single, Simultaneous Bidder Rule,” which barred bidders from using other agents and related parties to bid on the liens.

The plaintiffs, competing bidders against the defendants, alleged that the defendants violated the county’s single-bidder rule by arranging for related firms to bid on their behalf, resulting in the defendants’ fraudulent acquisition of a disproportionate share of liens.

The plaintiffs’ RICO claim was based on numerous acts of mail fraud that allegedly occurred when the defendants sent property owners certain notices required by Illinois law. The district court dismissed the RICO claim for lack of standing because the plaintiffs did not receive or rely on the alleged misrepresentations, despite their injuries.

On appeal, the 7th U.S. Circuit Court of Appeals reversed and held that the plaintiffs were entitled to relief under RICO, even though they did not rely on the alleged predicate acts of mail fraud.

Reliance

In a 9-0 decision, the Supreme Court affirmed and settled a circuit split by holding that a showing of first-party reliance — reliance by the plaintiff — on a defendant’s misrepresentations is not required when a plaintiff asserts a RICO claim based on mail fraud.

The court first noted that no showing of reliance is required to establish a violation of 18 USC 1962(c), stating that “[u]sing the mail to execute or attempt to execute a scheme to defraud is indictable as mail fraud, and hence a predicate act of racketeering under RICO, even if no one relied on any misrepresentation.” Similarly, the court refused to derive a first-party reliance requirement from Section 1964(c), which provides RICO’s civil cause of action and requires that a civil RICO plaintiff be “injured in his business or property by reason of” a violation of Section 1962.

The court also rejected additional arguments that: 1) first-party reliance is an element of common-law fraud, Congress intends to incorporate the well-settled meaning of the common-law terms it uses, and thus RICO should be read to incorporate a first-party reliance requirement in fraud cases; 2) first-party reliance is required to establish proximate causation under RICO; and 3) RICO should be interpreted to require first-party reliance so as to avoid the “over-federalization” of traditional state-law claims.
Proximate cause

Although the Phoenix Bond court spent the majority of its opinion explaining that first-party reliance is not an element of a RICO claim, the court also delivered sound advice to RICO practitioners in its discussion of the relationship between reliance and proximate cause. After stating that first-party reliance is not a bright-line prerequisite to the flexible concept of proximate cause, the court nevertheless noted that some sort of reliance likely must be shown to prove causation. “Of course, none of this is to say that a RICO plaintiff who alleges injury ‘by reason of’ a pattern of mail fraud can prevail without showing that someone relied on the defendant’s misrepresentation … it may well be that a RICO plaintiff alleging injury by reason of a pattern of mail fraud must establish at least third-party reliance in order to prove causation.” For instance, the court noted that if the third-party county had not accepted the false representations, the defendants would not have participated in the auction and there would have been no injury to the plaintiffs. And if the county knew that the representations were false, but allowed the defendants to participate in the auction anyway, there would be no reliance and no proximate cause because the county’s actions would break the causal chain between the misrepresentations and the plaintiffs’ injury.

The court’s holding did not alter the Anza rule that a plaintiff must show that it was directly injured by the RICO violation. In Phoenix Bond, the plaintiffs’ injury was the direct result of the fraud. Unlike the situation in Anza, there were no independent factors that accounted for the injury, there was no risk of duplicative recoveries by different plaintiffs, and there was no more immediate victim who was better situated to sue.

In sum, Phoenix Bond is an important case for RICO practitioners because it eliminates the judicially created first-party reliance requirement, which had become an obstacle to meritorious RICO claims in several jurisdictions. Plaintiffs will be permitted to bring RICO claims in select cases where the plaintiff’s injury was a direct and proximate result of the fraud, but a third party actually relied on the defendant’s misrepresentations. As a practical matter, however, the national landscape of RICO claims should not change drastically after Phoenix Bond. Although first-party reliance is not an element of mail fraud-based RICO claims, plaintiffs will continue to use first-party reliance to prove proximate cause in most cases.

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What courts required reliance?

Before Bridge v. Phoenix Bond & Indemnity Co., No. 07-210 (U.S. 06/09/08), when mail and wire fraud were the alleged predicate acts forming the racketeering activity, some courts required reliance on the fraud to satisfy RICO’s causation requirements. Here are some examples:

- Chisolm v. TranSouth Financial Corp., 95 F.3d 331 (4th Cir. 1996).
- Sandwich Chef of Texas, Inc. v. Reliance National Indemnity Insurance Co., 319 F.3d 205 (5th Cir. 2003).
- Appletree Square I Ltd. v. W.R. Grace & Co., 29 F.3d 1283 (8th Cir. 1994).