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Will 'Bridge' Lead To More RICO Fraud-Based Certifications?

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IN RECENT YEARS, an increasing number of federal appellate courts have declined to certify fraud-based suits brought under the Racketeer Influenced and Corrupt Organizations Act (RICO). Last May, the Second Circuit added to this trend, holding, in *McLaughlin v. American Tobacco Co.*, 522 F.3d 215 (2d Cir. 2008), that individualized issues of proximate causation, injury and damages precluded certification of a class of light cigarette smokers asserting RICO fraud-based claims against tobacco companies.

The question now is whether that trend will continue. Last June, the U.S. Supreme Court in *Bridge v. Phoenix Bond & Indemnity Co.*, 128 S. Ct. 2131 (2008), held that plaintiffs asserting a RICO claim predicated on mail fraud need not prove that they relied on the defendant's alleged misrepresentations. A few commentators have predicted that *Bridge* will undermine cases like *McLaughlin* and pave the way for more frequent certification of RICO fraud-based actions.

A close look at *Bridge* suggests that this likely will not be the case. While RICO claims predicated on mail fraud do not require a showing of first-party reliance, RICO's proximate causation requirement still presents a formidable obstacle to the certification of RICO-fraud based suits.

The Increase in RICO Class Actions

The increase in RICO class litigation in recent years is attributable to many factors.

The Class Action Fairness Act (CAFA), enacted in 2005, introduced significant changes to the class action landscape, sweeping a number of state class actions into federal court by relaxing the standards for removal. Before CAFA, plaintiffs bringing nationwide classes could assert state law claims in a favored state forum and press for certification. CAFA made those types of cases removable to the federal courts, where defendants have had relatively good success defeating state law based nationwide class actions on the ground that variations in state law prevent common issues from predominating over individual ones. See, e.g., *In re Bridgestone/Firestone Inc. Tires Prods. Liab. Litig.*, 288 F.3d 1012, 1015-18 (7th Cir. 2002).

The response of the plaintiff's bar to CAFA has been two-fold. Many class suits are now styled as single-state class actions in order to avoid the reach of CAFA's removal provisions.

But significantly, CAFA also has prompted plaintiffs bringing nationwide class litigation to turn away from state common law theories and toward federal statutes like RICO. Because RICO actions are often predicated on violations of the mail and wire fraud statutes, which are broad in scope, state-law fraud claims can be recast relatively easily as RICO claims, thereby avoiding the choice-of-law problems that bedevil nationwide state-law based actions. See, e.g., *Klay v. Humana*, 382 F.3d 1241 (11th Cir. 2004) (overturning certification of nationwide class on state-law based claims but affirming certification of a RICO class).

Second Circuit's 'McLaughlin' Ruling

The recent tide of RICO-based nationwide class actions has met an increasingly chilly reception in the federal courts of appeals.

RICO class actions are typically filed under Federal Rule of Civil Procedure 23(b)(3), which authorizes class certification when "questions of law or fact common to class members predominate over any questions affecting only individual members, and [when] a class action is superior to other available methods for fairly and efficiently adjudicating the controversy."

A number of federal courts have concluded that RICO fraud classes cannot satisfy Rule 23(b)(3) because individual issues of reliance and proximate causation predominate over issues common the class. See, e.g., *Sandwich Chef of Texas Inc. v. Reliance Nat'l Indem. Ins. Co.*, 319 F.3d 205, 219 (5th Cir. 2003) ("The pervasive issues of individual reliance that generally exist in RICO fraud actions create a working presumption against class certification.").

In *McLaughlin*, the Second Circuit added to this trend, reversing an order certifying, under Rule 23(b)(3), a nationwide class of smokers who alleged that tobacco companies' marketing misled them into believing that "light" cigarettes were healthier than full-flavored cigarettes. 522 F.3d at 220. The plaintiffs brought the action under RICO, alleging that the tobacco companies' deceptive marketing constituted mail and wire fraud and caused consumers to purchase light cigarettes in greater quantity, and at higher prices, than they would have had they known the truth. Judge Jack Weinstein in the Eastern District of New York certified a class of tens of millions of smokers on this theory.

In reversing the certification order, the Second Circuit held that plaintiffs could not establish their RICO claims through class-wide proof and therefore could not satisfy Rule 23(b)(3)'s requirement that common issues "predominate" over individual issues. In particular, the court held that there was no class-wide proof of reliance on the defendants' alleged misrepresentations because smokers could have purchased "light" cigarettes for many reasons wholly independent of the defendants' allegedly deceptive statements.

The plaintiffs contended that reliance effectively should be presumed because the allegedly deceptive statements "distorted the body of public information" about light cigarettes, and because consumers relied on the public's "general sense" that light cigarettes were healthier than full-flavored cigarettes. But the Second Circuit rejected that argument, holding that it was tantamount to the "fraud-on-the-market" presumption applicable to most securities cases under *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), and that courts could not assume that "regardless of whether individual smokers were aware of defendants' misrepresentation, the market at large internalized the misrepresentation to such an extent that all plaintiffs can be said to have

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relied on it." *McLaughlin*, 522 F.3d at 223-24.

The Second Circuit also held that the plaintiffs could not prove loss causation or injury through class-wide evidence.

High Court's 'Bridge' Decision

McLaughlin represents the most recent and fullest elaboration of the difficulties associated with certifying RICO fraud-based class actions. But just two months after *McLaughlin*, the Supreme Court decided *Bridge v. Phoenix Bond & Indemnity Co.*, supra, and held that a plaintiff asserting a RICO claim predicated on mail fraud need not plead or prove that he relied on the defendant's alleged misrepresentations. 128 S. Ct. at 2134.

Bridge involved a dispute between competitive bidders in tax lien auctions in Cook County, Ill. Because the bidding process often produced multiple tied bids, the county allocated liens "on a rotational basis" in order to ensure that they were apportioned fairly among the tied bidders. To prevent manipulation of the rotational system, the county also adopted a "Single, Simultaneous Bidder Rule" that required buyers to attest that they did not use agents to bid on their behalf in an effort to game the rotational system by securing a disproportionate share of liens on which the bids were tied. *Bridge*, 128 S. Ct. at 2135-37.

Two regular auction participants (Phoenix Bond and BCS Services Inc.) filed suit against Bridge and two other auction participants, alleging that they conspired to violate RICO by submitting false affidavits to the county affirming compliance with the Single, Simultaneous Bidder rule, and by using the mails to communicate with the owners of the properties whose liens they had won at auction. *Bridge*, 128 S. Ct. at 2135-37. In response, the purported conspirators argued that Phoenix Bond and BCS could not establish RICO's proximate causation requirement because they, unlike the county or the property owners, had never read or relied on any of the allegedly false statements.

The High Court rejected this argument, holding that RICO actions predicated on mail fraud do not require a showing of "first-party" reliance. *Bridge*, 128 S. Ct. 2138-39. The Court observed that neither the text of RICO nor the mail fraud statute requires proof of reliance and that it was not appropriate to construe RICO fraud claims to include the reliance element associated with common law fraud claims. Id. at 2139. The Court stated that, under the plain terms of the RICO statute, a person can be injured "by reason of" mail fraud even if he has not directly relied on any of the defendant's misrepresentations. Id.

Factoring In Proximate Causation

The future of RICO fraud class actions now largely turns on whether *Bridge* is viewed as having undermined *McLaughlin* and similar cases.

Some courts and scholars plainly think it has. See, e.g.:

• *Spencer v. The Hartford Financial Servs. Group Inc.*, 2009 WL 637676, at *12 (D. Conn. March 10, 2009) (certifying a RICO class and stating that, after *Bridge*, *McLaughlin* is "no longer good law on the question of whether a plaintiff must show that he or she was personally a recipient of a material misrepresentation");

• Richard Nagareda, "Class Certification in the Age of Aggregate Proof," 84 N.Y.U. L. Rev. 97, 147 (2009) ("*Bridge* sweeps away reliance as a potential basis for dissimilarities within proposed RICO classes just as effectively as the fraud-on-the-market doctrine does for run-of-the-mill securities classes.");

• John C. Coffee, Jr. & Daniel Wolf, "Class Certification: Developments Over the Last Five Years 2003-2008," 9 Class Action Litig. Rep. (BNA) No. 3, at * 3 (Oct. 31, 2008) (stating that "the Bar does not seem to have yet realized the full implications of *Bridge*" and suggesting that consumer fraud actions can now be "restyled as RICO cases in order to eliminate the need to show reliance on a class-wide basis").

Notably, in September 2008, Judge Weinstein, whose certification order had been reversed in *McLaughlin*, certified a RICO class of third-party payors (insurance companies and union benefit plans) seeking to recover alleged overpayments for Eli Lilly's antipsychotic medication Zyprexa based on allegations that false statements about the medication's safety and efficacy induced physicians to prescribe it. *In re Zyprexa Prods. Liab. Litig.*, 253 F.R.D. 69 (E.D.N.Y. 2008).

Stating that *McLaughlin* had been "placed in doubt" by *Bridge*, Judge Weinstein held that class-wide evidence demonstrated that prescribing doctors generally had relied on Eli Lilly's alleged fraudulent statements, even if the plaintiffs themselves had not done so, and that the individualized issues of reliance therefore did not preclude class certification. *In re Zyprexa*, 253 F.R.D. at 193-94. (The Second Circuit has granted Eli Lilly's Rule 23(f) and 1292(b) petition and briefing is likely to be completed this summer.)

These are early indications that *Bridge* has reshaped the RICO class action landscape. But a close analysis of *Bridge* suggests this perspective is likely to be short-lived.

While *Bridge* eliminates first-party reliance as an element of a RICO mail fraud claim, it did not disturb RICO's proximate causation requirement, which is set forth explicitly in the statute. See 18 U.S.C. §1964(c) (affording a civil cause of action to any person injured "by reason of" a violation of RICO's criminal provisions). The U.S. Supreme Court has twice emphasized that proximate causation is a demanding requirement. *Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451 (2006) and *Holmes v. Sec. Investors Prot. Corp.*, 503 U.S. 258 (1992). *Bridge* expressly reaffirmed that RICO plaintiffs must demonstrate that the defendant's wrongful conduct was the "proximate cause" of their injury while making clear that "first-party" reliance is not "always necessary" to make such a showing. *Bridge*, 128 S. Ct. at 2135-37.

Bridge is therefore unlikely to have a dramatic long-term impact on RICO fraud-based class actions. Even if first-party reliance is not required as a statutory matter under RICO, as a practical matter many RICO classes will continue to plead first-party reliance in order to establish the necessary causal link between the defendant's alleged wrongful conduct and the claimed injuries.

This will be true, for example, in most consumer fraud cases, where the plaintiffs allege that misrepresentations made to them were fraudule http://www2.istockphoto.com/file_thumbview_approve/837379/2/istockphoto_837379-highway-to-nonentity-in-buenos-aires.jpg nt under RICO. In that fact pattern, the *McLaughlin* line of cases holding that individual issues of reliance foreclose class certification should retain all of its force. Cf. *Dungan v. The Academy at Ivy Ridge*, 2008 WL 2827713, at *1 (N.D.N.Y. July 21, 2008) (denying motion for reconsideration of order denying certification, acknowledging *Bridge* but holding that "the problem for Plaintiffs is that they *do* allege that they relied on Defendant's claimed misrepresentations and that it was this first-person reliance that caused them to sustain damages" (emphasis in original)).

Moreover, although *Bridge* held that a RICO plaintiff need not have personally relied on the defendant's alleged misrepresentation, the Court also noted that a plaintiff may not be able to demonstrate proximate causation without proving that someone relied on the misrepresentation. *Bridge*, 128 S. Ct. at 2144 ("In most cases, the plaintiff will not be able to establish even but-for causation if no one relied on the misrepresentation."); see also id. ("[I]t 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.").

In a setting where allegedly fraudulent statements were made to a third party, RICO class plaintiffs still must establish the existence of the third-party's reliance in order to establish the causal link between the allegedly deceptive statement and the class members' injuries. Without third-party reliance, the "chain of causation" between a misrepresentation and plaintiff's injury is broken.

Absent adoption of a rule "presuming" reliance by third parties, or a rule embracing the "fraud on the market" doctrine in RICO fraud cases, establishing third-party reliance on a misrepresentation will require the same individualized inquiry that is required when first-party reliance is at issue. See *Ironworkers Local Union No. 68 v. Aztrazeneca Pharms. LP*, 585 F. Supp. 2d 1339, 1343 (M.D. Fla. 2008) (acknowledging *Bridge* but holding that, under *Holmes* and *Anza*, plaintiffs' allegations of third-party reliance were not enough to demonstrate that the defendants proximately caused their harm). Thus, reliance issues will likely remain highly relevant to the Rule 23(b)(3) predominance inquiry after *Bridge*.

Conclusion

The viability of RICO fraud-based damages class actions will be affected by many doctrinal developments, but the interplay between *Bridge* and the *McLaughlin* line of cases will be among the most important.

After *Bridge*, it is difficult to suggest that there should be a blanket rule that reliance issues make certifying RICO fraud-based classes impossible. But in most settings, a RICO plaintiff alleging mail fraud still must prove that someone relied on the defendant's alleged misrepresentations, and, in class litigation, establishing that reliance will often turn on individual rather than common proof. This means that, even after *Bridge*, Rule 23(b)(3)'s predominance inquiry is likely to prevent the certification of many RICO fraud-based class actions.