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The Supreme Court Stance On Hemi Group

Law360, New York (March 09, 2010) -- On Jan. 25, 2010, a sharply divided U.S. Supreme Court handed down Hemi Group LLC, et al. v. City of New York, (No. 08-969), construing the proximate cause requirement of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961-68, to preclude claims in which the alleged racketeering activity is not the direct cause of the plaintiff's injury.

The 5 – 3 decision is significant in that it prevents plaintiffs from pursuing RICO claims based on attenuated theories of causation, particularly where "multiple steps" — particularly the intervening acts of "third and even fourth parties" — "separate the alleged fraud and the asserted injury."

The court also held that as a threshold matter, RICO plaintiffs "cannot escape the proximate cause requirement merely by alleging that the fraudulent scheme embraced all those indirectly harmed by the alleged conduct."

As pointed out in the vigorous dissent, however, the majority decision injects a degree of uncertainty into the law governing RICO causation by replacing the traditional hallmark of proximate cause — the "foreseeability" of an injury — with the more undefined requirement of "directness."

Moreover, the position of Justice Ruth Bader Ginsburg, who concurred in both the court's opinion and the judgment but declined to endorse either the proximate cause analysis of the dissent or the majority, means that this significant addition to RICO proximate cause precedent rests on a functional plurality.

In any event, the decision highlights the importance of proximate cause as a tool for defendants to secure early dismissal of RICO claims — and avoid notoriously costly discovery — where the allegations do not set forth a clear causal link between the alleged racketeering and the alleged injury.

Supreme Court RICO Causation Jurisprudence

Under RICO, a plaintiff only has standing to bring a claim when he is "injured in his business or property by reason of a violation" of the statute. Id. § 1964. To show a violation of the statute, a plaintiff must show that the defendant operated as part of an enterprise to commit a series of so-called "predicate acts," specific criminal offenses such as mail or wire fraud, over time.

Starting with its decision in Holmes v. Securities Investor Protection Corp., 503 U.S. 258, 268 (1992), the court has construed the "by reason of" language to incorporate common law principles of proximate cause, including the requirement that there be "some direct relation between the injury asserted and the injurious conduct alleged."

In Anza v. Ideal Steel Supply Corp, 547 U.S. 451, 458-61 (2006), the court highlighted the importance of the directness requirement, noting that "[w]hen a court evaluates a RICO claim for proximate causation, the central question it must ask is whether the alleged violation led directly to the plaintiff's injuries."

And most recently in Bridge v. Phoenix Bond and Indemnity Co., 553 U.S. __ (2008), a unanimous court held that to have standing under RICO, a plaintiff need not show its own reliance in the context of underlying predicate acts of fraud; as long as the theory of causation is “straightforward,” there are “no independent factors that account for the injury” such that the alleged racketeering conduct is the direct cause.

Background of Hemi Group

In Hemi Group, the City of New York sought to recoup lost tax collections that it traced to the alleged RICO violations of an out-of-state cigarette vendor.

Under the City's theory, the out-of-state vendor committed predicate acts by failing to disclose to New York State the identities of New York State purchasers (as required by the Jenkins Act), thereby preventing the State from reporting to the City the names of purchasers that resided in the City, resulting in the City being unable to collect any unpaid taxes from those purchasers.

The district court dismissed the City's claims, but the Second Circuit Court of Appeals reversed, holding, inter alia, that the claimed injuries came about “by reason of” the alleged racketeering conduct.

The specific question before the court in Hemi Group was whether RICO standing is present where the plaintiff's alleged injury results from “non-payment of taxes by non-litigant third parties.”

To answer the question, the majority focused on whether the relationship among the State, the City, the out-of-state vendor and the purchasers, taking into account the nature of the alleged RICO violation, demonstrated a causal link that satisfied RICO's proximate cause requirement.

Decision, Concurrence, Dissent

Justice John Roberts, writing for the court in an opinion joined by Justices Antonin Scalia, Clarence Thomas and Samuel Alito, found that the City did not show that its injury of lost tax revenue was caused “by reason of” the defendant's unlawful failure to report its sales of cigarettes to New York residents. Decision at 5.

Citing the traditional common law proximate causation principles as well as the trilogy of Holmes, Anza and Bridge, the court found that the New York City purchasers' failure to pay taxes was responsible for the City's injury, not the out-of-state vendor's failure to file the purchaser list with the State.

Because “‘[t]he general tendency of the law, in regard to damages at least, is not to go beyond the first step,'” a tendency that the court found “applies with full force to proximate cause inquiries under RICO,” the Court determined that the City's theory of causation was too attenuated. Id. at 7 (quoting Holmes).

Finding that the City's theory “requires that we extend RICO liability to situations where the defendant's fraud on the third party (the State) has made it easier for a fourth party (the taxpayer) to cause harm to the plaintiff (the City),” the court declined to “stretch the causal chain of a RICO violation” in such an unprecedented fashion. Id. at 8.

In addition to finding fault with the City's theory of causation, the court also found the City's theory of liability lacking. Specifically, the court rejected the City's characterization of the alleged RICO violation as the vendor's participation in a broad, fraudulent “systematic scheme” as opposed to individual predicate acts of fraud. Id. at 10.

The court found that allowing RICO plaintiffs to bring conduct within the ambit of the statue merely by alleging a “scheme” converted the court's “RICO proximate cause precedent [into] a mere pleading rule.” Id. at 10.

Because the City's theory of “scheme” liability necessarily “rests on the independent actions of third and even fourth parties,” the court found that the City could not state a claim under RICO. Id. at 12.

The majority criticized the dissent, which itself echoed Justice Thomas' dissent in Anza, for its insistence on “foreseeability” as the cornerstone of the RICO proximate cause analysis, as opposed to “directness.” Id. at 9-10.

“Our precedents make clear that in the RICO context, the focus is on the directness of the relationship between the conduct and the harm. Indeed, Anza and Holmes never even mention the concept of foreseeability.” Id. at 10.

The dissent, in turn, challenged that the majority misunderstood the relationship between the words “direct” and “foreseeable” at common law and misconstrued the Court's use of those terms in Holmes, Anza and Bridge. Dissent at 5-7.

Specifically, the dissent charged that the majority's requirement of a “direct” causal link, defined as something more than mere foreseeability, takes the Hemi Group decision outside the bounds of precedent.

Drawing on historical cases and treatises, the dissent found that “courts used this concept of directness in tort law to expand liability (for direct consequences) beyond what was foreseeable, not to eliminate liability for what was foreseeable,” and that “this Court's opinions in Holmes or Anza [do not] invoke anything other than this traditional understanding.” Id. at 7-8.

The dissent cited the foreseeability of the failure of the defendant vendor's purchasers to pay tax to the City, the defendant's apparent intent that the purchasers not pay the tax, and the fact that the defendant's actions made that failure more likely as reasons why the court should have found the proximate cause requirement to be satisfied under traditional principles. Id. at 6-7.

The dissent predicted that the majority's decision would allow fraudfeasors to avoid liability simply by employing intermediaries to prevent a finding of “direct” causation, thereby “free[ing] from liability defendants who would appear to fall within [RICO's] intended scope.” Id. at 11.

Justice Ginsburg concurred in the court's judgment and joined the majority's opinion to the extent that it comported with her inclination to “resist reading RICO to allow the City to end-run its lack of authority to collect tobacco taxes” or to expand liability for violations of the Jenkins Act. Concurrence at 2. However, she expressly declined to subscribe to the majority's proximate cause analysis and was silent as to the dissent's. Id.

Significance of the Decision

The decision is promising for RICO defendants, who often face burdensome discovery when courts allow claims to survive a motion to dismiss despite the fact that plaintiffs allege only a vague “scheme” with a weak causal link to the asserted injury. The Hemi Group opinion may prove to be powerful authority in the context of a motion to dismiss based on causation grounds.

More generally, the decision may be perceived as a reversal of the court's recent disinclination to cabin the broad language of RICO, seen recently in Bridge in 2008, with the decision not to require first-party reliance to confer RICO standing, and in Boyle v. United States, 556 U.S. __, in 2009, in which the court endorsed an expansive definition of what may comprise an “enterprise” for purposes of RICO.

However because of the sharp split of the court, along with Justice Ginsburg's silence on the proximate cause issue, the legacy of Hemi may ultimately be a series of lower court decisions searching for what constitutes a sufficiently “direct” causal connection between racketeering conduct and an alleged injury to provide standing to bring a RICO claim, and perhaps a revisiting of the question by the Supreme Court.

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