

R.I.C.O.: Reviewing an Insidious Court Overstep

INTRODUCTION: The City of New York ("City") imposes a cigarette tax on top of the NY State cigarette tax.¹ Hemi Group, a New Mexico corporation², is neither required by the State nor the City to collect that tax³, but where a customer ships cigarettes into NY State, the Jenkins Act requires Hemi to supply that customers' information to the State.⁴ The State then voluntarily forwards that information to the City where applicable.⁵ Hemi advertises to its customers that it will not report that information to either the State nor the City.⁶ City customers pay less out-of-pocket for cigarettes when buying through Hemi as compared to purchases from in-state brick-and-mortar stores, as the latter purchases include the tax costs into their price-per-pack.⁷ The City filed this action for civil recovery under the Racketeer Influenced and Corrupt Organizations Act ("RICO"), alleging mail and wire fraud as the requisite predicate offense.⁸

The majority held that the City cannot satisfy RICO's proximate causation requirement.⁹ The "conduct directly causing the harm was distinct from the conduct giving rise to the fraud"¹⁰, that is the taxpayers are the parties responsible for the harm, not Hemi.¹¹ The majority further rejects the City's characterization of the violation as a comprehensive scheme to defraud the City¹², and distinguishes this case from *Phoenix*

Bond.¹³ Ginsburg concurred in-part and in-judgment, and underscored that even in compliance with the Jenkins Act, Hemi would owe no duty to disclose information to the City.¹⁴ Breyer dissents, joined by Stevens and Kennedy. The dissent found proximate causation¹⁵ and that the City's loss of tax revenue is property.¹⁶

BACKGROUND: Cigarette and tobacco taxes are state excise taxes.¹⁷ Further, NY State authorizes the City to collect tax on-top of the state tax.¹⁸ The cost of these taxes are already folded into the price when the distributors sells to the retailer.¹⁹ Because the tax rate varies among the states²⁰, mail-order sales from low-tax states to high-tax states increased.²¹ The states began losing significant tax revenue because residents would fail to report out-of-state shipments.²² This compelled the federal government to pass the Jenkins Act²³; it requires sellers to report purchase data to the resident's home state to assist in tax collection.²⁴

The RICO act was passed to reach organized crime syndicates²⁵, but to ensure it would not be struck down as a status offense²⁶ it was drafted broadly, elevating already criminal conduct when it "had a corrupting influence on legitimate business."²⁷ RICO requires: (1) a predicate act²⁸; (2) a pattern of racketeering acts²⁹; (3) the corruption of an enterprise.³⁰ RICO allows the government to pursue criminal

sanctions³¹, but it also allows for private enforcement by creating a civil cause of action for RICO violations³², awarding treble damages.³³

The predicate act on issue is mail³⁴ and wire fraud.³⁵ These particular acts were used by the courts to expand RICO's reach to offenses otherwise not delineated as predicate acts.³⁶ While "pattern" is defined broadly in the criminal RICO context, to establish a pattern for civil recover, one must demonstrate that "the defendant's predicate offenses are related and continuous or at least pose the threat of continuity."³⁷ *Phillips* held that a governmental entity can qualify as a "person" who has standing to recover civil damages under RICO.³⁸

The District Court dismissed, holding that "the City could not establish that Hemi and Gachupin [Hemi's owner] formed an 'enterprise'."³⁹ because Gachupin "did not have an individual duty to file Jenkins Act reports."⁴⁰ The Second Circuit vacated and remanded the judgment, deciding that by failing to file Jenkins reports to the State, Hemi and Gachupin "operated as an 'enterprise'."⁴¹ On appeal, Hemi raised the question as to "whether the City had been 'directly injured in its 'business or property'' by reason of the alleged mail and wire frauds."⁴²

ANALYSIS: The Court splits the question into two issues: (1) does "business or property" include a loss of tax revenue?; (2) does "the City's asserted injury [come] about 'by reason of' the

allegedly fraudulent conduct?"⁴³ The Court dismisses the case with the latter question and does not address the former.⁴⁴

The Court cites and compares *Holmes*, which declared proximate cause as a necessary showing in addition to but-for cause.⁴⁵ The Court used common-law foundations to deem links that are too remote or indirect, or those which are purely contingent to be insufficient.⁴⁶ Here, the Court finds that the injury to the City fails "RICO's direct relationship requirement"⁴⁷ because it was removed "beyond the first step"⁴⁸; its analysis would require examining the links between the City, the State, Hemi and its customers.⁴⁹

Further, the Court cites *Anza* to show its claim's defect is the same as the instant claim's defect: the conduct causing the harm (the customers' failure to pay taxes) is distinct from the fraudulent conduct (failure to file under the Jenkins Act).⁵⁰ Further, while in *Anza* National Steel engaged in both conducts, here the conducts were carried out by distinct parties.⁵¹

The City tries to recast the violation as a "systematic scheme to defraud the City of tax revenue"⁵², but the Court finds that the City still "must show that Hemi's failure to file the Jenkins Act reports with the State led directly to its injuries"⁵³ and that the City cannot do so⁵⁴. The City relies on *Bridge*, but the Court distinguishes it because in *Bridge* "there were 'no independent factors that account[ed] for [the

plaintiff's] injury"⁵⁵, but here the "City's theory of liability rests on the independent actions of third and even fourth parties."⁵⁶ Finally, the Court declines to consider the City's shift from mail fraud to misrepresentation as the predicate act because the City failed to so plead at the District Court⁵⁷.

Ginsburg concurs in-part and in-judgment, without joining with the majority's proximate cause analysis, and holds that the City's "claim is outside the scope of the very statute on which it builds its RICO suit."⁵⁸

Breyer, dissenting, joined by Stevens and Kennedy, finds proximate causation.⁵⁹ Proximate cause most often discusses foreseeability, and here the City's losses are "reasonably foreseeable."⁶⁰ Further, Hemi intentionally misrepresented material facts, and "all intended consequences" of that "intentional act 'are proximate'."⁶¹ To counter the majority's holding that the causal chain was broken because the customers caused the City's harm, Breyer notes that "an intervening third-party act, even if criminal, does not cut a causal chain where the intervening act is foreseeable and the defendant's conduct increases the risk of its occurrence."⁶² To counter the majority's finding that Hemi made misrepresentations to the State instead of the City, Breyer notes that "under the common law a fraud may be established when the defendant has made use of a third party to reach the target of the fraud."⁶³ Breyer

distinguishes *Anza* because the kind of harm alleged there differed from that which the statutes meant to protect from, and so the alleged harm was neither intended nor foreseeable.⁶⁴ Breyer finds that in *Bridge* the harm was foreseeable, intended, and exactly the kind of harm that was legislated against.⁶⁵ Breyer concludes by establishing the right to uncollected taxes as property under RICO.⁶⁶

EVALUATION: The Court errs in continuing to require a proximate cause analysis when neither Congress envisioned such a constraint, nor is it required under common law principles. Regardless, the application of a proximate cause limitation is unnecessary and unjustified in the instant case.

The text of the RICO statute is expansive in nature, granting civil remedy to "any person injured."⁶⁷ In adopting RICO, Congress intended to allow legitimate business interests to recover for its injuries⁶⁸, otherwise it would have provided only criminal sanctions. Congress is aware of RICO's scope, has had the opportunity to review it⁶⁹, and has chosen to leave it as expansive as currently provided.⁷⁰ Congress, not a court, must be the party to add proximate causation if it so desires⁷¹, but it has demonstrated that it does not⁷².

The Court adopts a proximate cause analysis partially drawn from negligence torts, but the City's injuries do not derive from negligence. Hemi did not accidentally breach a duty; it

knew of its duty to report under the Jenkins Act, it knew failure to do so would deprive both City and NY State of its tax revenue, and it took actions to profit from that deprivation.⁷³ The correct analogy would be to an intentional tort. Under common law, a proximate causation analysis is inapplicable for intentional torts.⁷⁴

Further, the Court relies on *Holmes*⁷⁵; in *Holmes*, the Court compares RICO to the Clayton Act on the sole basis that the latter was the model for the former⁷⁶, but this comparison is inappropriate. Anti-trust litigation is by nature nebulous and potentially boundless; a single monopoly might affect even industries outside its own. Thus, a proximate cause analysis is appropriate in the context of the Clayton Act, because without such a requirement the liability may well be limitless.⁷⁷ In the instant case, a RICO violation in the context of cigarette taxes does not have that same potential problem; the number of injured parties, the scope of injury, and the magnitude of injury are all naturally limited.⁷⁸ The City is logically within the realm of parties injured by Hemi's actions and any recovery would not be speculative in nature. Hemi's actions were targeted at both NY State and the City, and regardless of how the City comes to its injuries, those injuries are finite, calculable, and their infliction was intended.

The Court is not presented with a plaintiff so far removed as to render the case nonjusticiable.⁷⁹ The relationship between NY State and the City was not surreptitious; Hemi knew of the agreement between those parties⁸⁰. That is not to say that any relationship known by the defendant, contractual or otherwise, would allow for plaintiff's recovery in every instance, but here there is a distinction. Here the City was not an innocent bystander, removed from injury, seeking recovery⁸¹; it, along with NY State, was the target of a systematic methodology intended to derive profit for Hemi and deprive the City and NY State of tax revenue.

CONCLUSION: The Court erred in sustaining the precedentially established requirement for a showing of proximate cause. Its conception in *Holmes* was based on a flawed comparison to the Clayton Act; a proximate causation analysis is inapplicable in intentional torts; such a requirement was deliberately excluded by Congress; and regardless, the conditions that would otherwise compel the application of a proximate causation analysis do not exist in the instant case. Congress deliberately intended for this type of violation to exist within the RICO statute, and this decision unnecessarily removes it.

¹ *Hemi Group and Kai Gachupin v. City of New York, New York*, No. 08-969, slip op. at 2 (U.S. Jan. 25, 2010).

² *Id.* at 1.

³ *Id.*

⁴ *Id.* at 2.

⁵ *Id.* at 2-3.

⁶ *Id.* at 14.

⁷ *Hemi*, No. 08-969, Breyer, J., dissenting, slip op. at 3.

⁸ *Hemi*, No. 08-969, slip op. at 1.

⁹ *Id.* at 1, 5.

¹⁰ *Id.* at 8 (citing *Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451, 458 (2006)).

¹¹ *Id.* at 8.

¹² *Id.* at 10.

¹³ *Id.* at 11.

¹⁴ *Hemi*, No. 08-969, Ginsburg, J., concurring, slip op. at 1-2.

¹⁵ *Hemi*, No. 08-969, Breyer, J., dissenting, slip op. at 1.

¹⁶ *Hemi*, No. 08-969, Breyer, J., dissenting, slip op. at 11-13.

¹⁷ Samantha K. Graff, *State Taxation of Online Tobacco Sales: Circumventing the Archaic Bright Line Penned by Quill*, 58 FLA. L. REV. 375, 379 (2006).

¹⁸ *Hemi*, No. 08-969, slip op. at 2 (citing N.Y. Unconsol. Law Ann. §9436(1) (West Supp. 2009)).

¹⁹ Graff, *supra* note 17, at 380.

²⁰ *Id.*

²¹ *Id.* at 382.

²² *Id.*

²³ *Id.* at 382-83.

²⁴ *Id.*

²⁵ Terrance G. Reed, *The Defense Case for RICO Reform*, 43 VAND. L. REV. 691, 693 (1990).

²⁶ *Id.*

²⁷ *Id.* at 694.

²⁸ 18 U.S.C. § 1962(a) (2006).

²⁹ 18 U.S.C. § 1962(b) (2006).

³⁰ 18 U.S.C. § 1962(c) (2006).

³¹ 18 U.S.C. § 1963 (2006).

³² 18 U.S.C. § 1964 (2006).

³³ 18 U.S.C. § 1964(c) (2006).

³⁴ As defined in 18 U.S.C. § 1341 (2006).

³⁵ As defined in 18 U.S.C. §1343 (2006).

³⁶ Reed, *supra* note 25, at 697.

³⁷ *Id.* at 698 (citing *H.J. Inc. v. Northwestern Bell Telephone Co.*, 109 S.Ct. 2893, 2902 (1989)).

³⁸ See *Illinois Department of Revenue v. Phillips*, 771 F.2d 312, 314, 316 (7th Cir. 1985).

³⁹ *Hemi*, No. 08-969, slip op. at 4.

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.* at 5.

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *Id.* at 6.

⁴⁷ *Id.*

⁴⁸ *Id.* at 7.

⁴⁹ *Id.* at 6-7.

⁵⁰ *Id.* at 8.

⁵¹ *Id.*

⁵² *Id.* at 10.

⁵³ *Id.* at 11.

⁵⁴ *Id.*

⁵⁵ *Id.* at 12.

⁵⁶ *Id.*

⁵⁷ *Id.* at 14-15.

⁵⁸ *Hemi*, No. 08-969, Ginsburg, J., concurring, slip op. at 2.

⁵⁹ *Hemi*, No. 08-969, Breyer, J., dissenting, slip op. at 1.

⁶⁰ *Id.* at 4.

⁶¹ *Id.* at 5.

⁶² *Id.* at 7.

⁶³ *Id.* at 8 (citing *Tanner v. United States*, 483 U.S. 107, 129 (1987)).

⁶⁴ *Id.* at 10.

⁶⁵ *Id.*

⁶⁶ *Id.* at 11-13.

⁶⁷ 18 U.S.C. § 1964(c) (2006).

⁶⁸ *Reed*, *supra* note 25, at 693.

⁶⁹ *Id.* at 720.

⁷⁰ *Id.*

⁷¹ *See, e.g., Phillips*, 771 F.2d at 317 (quoting *Haroco v. American Nat'l Bank & Trust Co. of Chicago*, 747 F.2d 384, 399 (7th Cir. 1984)) ("Even if Congress did not anticipate all of the consequences of RICO, the breadth of the state, including the civil provisions, was the result of deliberate policy choices on the part of Congress. . . . When Congress deliberately chooses to unleash such a broad statute on the nation, in the absence of constitutional prohibitions, complaints must be directed to Congress rather than to the courts.").

⁷² *Reed*, *supra* note 25, at 720.

⁷³ *Hemi*, No. 08-969, Breyer, J., dissenting, slip op. at 3.

⁷⁴ See, e.g., *Assoc. Gen. Contractors of Cal. v. Cal. St. Council*, 459 U.S. 519 (1983) (Marshall, J., dissenting) (“Although many legal battles have been fought over the extent of tort liability for remote consequences of negligent conduct, it has always been assumed that the victim of an intentional tort can recover from the tortfeasor if he proves that the tortious conduct was a cause-in-fact of his injuries. An inquiry into proximate cause has traditionally been deemed unnecessary in suits against intentional tortfeasors.”); RESTATEMENT (SECOND) OF TORTS § 435A (1965).

⁷⁵ *Hemi*, No. 08-969, slip op. at 5.

⁷⁶ *Holmes v. Securities Investor Protection Corporation*, 503 U.S. 258, 267 (1992).

⁷⁷ See, e.g., *Assoc. Gen. Contractors of Cal.*, 103 S.Ct at 536-37 (the purpose of a proximate cause analysis is to limit liability from “every conceivable harm” and to limit the number of possible plaintiffs).

⁷⁸ Here, the possible parties are limited to just NY State and the City.

⁷⁹ For example, if the plaintiff were a City resident receiving welfare, who was suing Hemi because Hemi’s actions caused a slight drop in welfare benefits.

⁸⁰ *Hemi*, No. 08-969, Breyer, J., dissenting, slip op. at 9.

⁸¹ For example, the previously given hypothetical welfare recipient