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Energy

Class Action Nuclear Device Puts Big Business on Guard

By Perry Cooper

Oct. 18 — Civil federal racketeering class actions are the "litigation equivalent of a thermonuclear device," the nation's leading business group warned the Fifth Circuit in April.

The civil RICO statute authorizes recovery of treble damages and attorneys' fees, plus class status can multiply a company's potential liability by hundreds or even thousands, the U.S. Chamber of Commerce said.

Courts should require that RICO civil suits meet strict requirements for class certification, it said. If courts allow plaintiffs to presume away individual issues of causation and reliance, "a wide range of businesses will be at risk of being held hostage by the filing of putative class actions based on spurious claims."

On Sept. 30, the full Fifth Circuit—in the business group's parlance—took the nuclear option when it upheld certification of RICO class claims that an alleged pyramid scheme caused plaintiffs to lose money.

The en banc appeals court, disagreeing with a three-judge panel, held that fraud-based claims under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961, don't require proof that each plaintiff relied on the defendant's alleged misrepresentations to establish that the injuries were proximately caused by the fraud (*Torres v. S.G.E. Mgmt. LLC*, 2016 BL 326050, 5th Cir. *en banc*, No. 14-20128, 9/30/16) (17 CLASS 1029, 10/14/16).

Snapshot

- Chamber of Commerce says expansion of federal racketeering class actions could be a serious threat to business
- But professor says RICO is important tool for plaintiffs to use against complex organizations

RICO on the Rise

It's now enough in the conservative Fifth Circuit—which includes courts in Texas, Louisiana and Mississippi—to show that a hypothetical, rational person would have relied on the defendant's alleged misrepresentations to establish that common questions predominate in the litigation, Pamela Bucy Pierson told Bloomberg BNA recently. Pierson teaches civil procedure and white collar crime at the University of Alabama School of Law in Tuscaloosa, Ala.

The Fifth Circuit joined the Sixth and Seventh circuits, which have already adopted this inference-based theory of causation for RICO cases, she said.

This trend among the circuits is "going to make RICO more and more viable as a class action vehicle," Pierson said.

Appellate litigator Raffi Melkonian agreed that the reliance ruling helps RICO civil class actions generally.

"Certainly the amicus parties that joined the case think that," Melkonian, partner at Wright & Close LLP in Houston, told Bloomberg BNA. He referred to the brief filed by the Chamber, joined by the Direct Selling Association and the National Energy Marketers Association.

"They all said that businesses are going to be put under the hammer of the RICO class action—not just direct-seller businesses, but all kinds of businesses" because it loosens the standards for class certification, he said.

Indeed, after the en banc Fifth Circuit's ruling came down, the Washington Legal Foundation, a free-market oriented public-interest law firm, echoed the Chamber's warnings about the threat of RICO class actions.

"If the inherently individualized issues of causation or reliance could be inferred instead of proven for a claim with the unparalleled breadth and remedies of civil RICO, it would dramatically increase the burden on the federal courts, impose higher litigation costs on a wide range of businesses, force defendants into coercive settlements of unmeritorious claims, and produce a great injustice," Cory Andrews, senior litigation counsel at the WLF, told Bloomberg BNA.

But Melkonian, who clerked for a Fifth Circuit judge, isn't entirely convinced the situation is as dire as these groups predict.

For plaintiffs bringing class actions against pyramid schemes specifically, "it's a slam dunk," Melkonian said. "This case gives you a blueprint of what do to."

But, in general, "a RICO class action still requires a pretty high pleading standard," he said. "This case was pretty compelling and that's why it's gone this far."

Not Just for Gangsters Anymore

RICO was enacted in 1970 with organized crime in mind. Its criminal cause of action was used to take down Mafia crime rings.

Pierson said use of criminal RICO has decreased because more streamlined statutes are available.

But its civil cause of action, she argues, is on the rise.

RICO's civil side is "becoming more and more empowered" at a good time for class action plaintiffs.

Courts have been cutting back on the use of class actions in other circumstances, she said. And the Class Action Fairness Act has made class actions almost nonexistent in state court, where they used to be prevalent.

"The fact that RICO is on the rise as other opportunities to bring class actions are diminishing is really significant," Pierson said.

A claim for civil RICO requires plaintiffs to prove defendants engaged in a "pattern of racketeering activity." The statute lists crimes that constitute racketeering activity, including mail and wire fraud. Wire fraud can be applied to a broad range of business communications including those by telephone, e-mail and text.

She said RICO is poised to see huge growth in fraud cases as the world gets more complicated. The internet and corporate law allow businesses to complicate their structures until it's not quite clear who the owners are, she said. "RICO fits that kind of layering and complexity really well."

Pierson pointed to a wide variety of recent high-profile issues that have drawn RICO civil claims including the water crisis in Flint, Mich.; Volkswagen's emissions scandal; Theranos Inc.'s blood testing claims; and Trump University's advertising practices.

It's also been particularly useful when plaintiffs, such as union health and welfare funds, sue pharmaceutical companies for allegedly fraudulent misrepresentations of drugs they make or market, she said.

"The variety of cases being brought as RICO civil actions in the past two to three years is astounding!" she said. "Bottom line: RICO is so versatile it fits any situation where multiple actors engage in wrongdoing."

Limited Holding

But other attorneys told Bloomberg BNA they wouldn't go so far about the importance of the Fifth Circuit's en banc decision.

An amicus for the plaintiffs said the ruling is an "important recognition that at least some kinds of fraud cases can proceed on a class basis because common questions predominate."

Because RICO doesn't have an individual reliance element, it "can be a useful basis for class actions in appropriate cases," Scott L. Nelson of consumer interest group Public Citizen in Washington told Bloomberg BNA in an e-mail.

"It is a positive sign that the court of appeals is open to arguments that class treatment is appropriate in a particular case and isn't applying a knee-jerk rule that if it's fraud, it can't be a class action," he said.

Defense attorney Donald R. Frederico of Pierce Atwood LLP in Boston said he doesn't think the decision will lead to more RICO claims because it is limited to the facts of this case.

"Had the case not involved an alleged pyramid scheme, it very well might have come out differently," he told Bloomberg BNA in an e-mail.

"Plaintiffs class action lawyers no doubt will cite *Torres* as additional authority for the argument that RICO claims do not require proof of reliance," he said.

But "the decision may not help them in cases not involving pyramid schemes, or in which defendants submit individualized evidence that would defeat a finding of reliance or break the chain of causation for some class members."

Next Stop: SCOTUS?

Melkonian, the appellate attorney, predicted the case might make it onto the U.S. Supreme Court's docket, even in this time of uncertainty for the court.

"It's a non-controversial case politically," he said. "Yes, it's a class action but it's not that extreme."

Professor Pierson agreed. "This is a big deal for both sides," she said. "I think that's why the Fifth Circuit took it en banc, " Pierson said, noting how rare it is for a full court to undo a panel's decision.

The Fifth Circuit's ruling "could really hurt defendants—so I'm sure they are going to try to get as much clarification on it as they can and try to get it overruled," she said.

She also predicted the top court would uphold the ruling, as it builds on its 2008 decision in *Bridge v. Phoenix Bond & Indemnity Co.* She described *Bridge* as the case that "opened the door to the contemporary use of RICO in fraud cases."

In *Bridge*, a case about tax liens, the Supreme Court held that plaintiffs asserting RICO claims predicated on mail fraud don't have to show—either as an element of their claims or as a prerequisite to establishing proximate causation—that they relied on the defendant's alleged misrepresentations.

"RICO truly is as broad as the Fifth Circuit says," Pierson said.

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The opinion is at http://www.bloomberglaw.com/public/document/Torres_v_SGE_Mgmt_LLC_No_1420128_2016_BL_326050_5th_Cir_Sept_30_2/1.

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