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No. 07-210

In The
Supreme Court of the United States

JOHN BRIDGE, et al.,

Petitioners,

v.

PHOENIX BOND & INDEMNITY CO., et al.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

BRIEF FOR MCKESSON CORPORATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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TABLE OF CONTENTS

	Page
TABLE OF CONTENTS	i
TABLE OF AUTHORITIES	iv
BRIEF FOR MCKESSON CORPORATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS	1
INTEREST OF *AMICUS CURIAE*	1
INTRODUCTION AND SUMMARY OF ARGUMENT	3
ARGUMENT	9
CONGRESS INCORPORATED COMMON LAW PRINCIPLES, INCLUDING JUSTIFIABLE RELIANCE BY THE PLAINTIFF, INTO PRIVATE CIVIL RICO ACTIONS PREDICATED ON MAIL FRAUD	9
A. This Court's Longstanding Interpretation Of The "By Reason Of" Requirement In The Civil RICO Cause Of Action, 18 U.S.C. § 1964(c), Relies On The Common Law	10
1. Interpretation of Section 1964(c) is guided by the common law principles applicable to "comparable litigation," and a Section 1964(c) civil RICO cause of action predicated on mail fraud is comparable to a common law fraud action	10
2. Justifiable reliance by the plaintiff is a necessary component of causation in any common law fraud action	13

TABLE OF CONTENTS—Continued

Page

3. The ruling below violates well-settled principles of common law fraud 19

B. The Common Law Does Not Support The Judgment Below Allowing Respondents To Seek Treble Damages Without Any Showing That They Directly And Justifiably Relied On The Alleged Fraud 20

1. A third party's reliance on a fraud defendant's purported misrepresentation does not satisfy the common law fraud reliance requirement 20

2. Allowance of "scheme" liability for criminal prosecution under Section 1341 does not eliminate the common law reliance requirement for a person seeking civil RICO treble damages under Section 1964(c) for an alleged injury "by reason of" predicate mail fraud 24

3. A presumption of reliance has no place in common law fraud, and thus is inapplicable to civil RICO predicated on mail fraud 27

C. The Common Law Reliance Requirement Ensures That Civil RICO Predicated On Mail Fraud Does Not Become A Business Tort Statute For Disappointed Competitors Or Parties To Commercial Contracts................. 29

TABLE OF CONTENTS—Continued

Page

1. Civil RICO mail fraud class actions will proliferate if plaintiffs are not required to prove their own justifiable reliance 29

2. Even if the Court chose to depart from common law principles, any allowance for third-party reliance should preclude recovery for derivative injuries 33

CONCLUSION.. 36

TABLE OF AUTHORITIES

Page

CASES:

Anza v. Ideal Steel Supply Corp., 126 S. Ct. 1991 (2006) .... *passim*

Appletree Square I, Ltd. Partnership v. W.R. Grace & Co., 29 F.3d 1283 (8th Cir. 1994) 19

Associated General Contractors of California, Inc. v. State Council of Carpenters, 459 U.S. 519 (1983) 5, 11, 12

Basic Inc. v. Levinson, 485 U.S. 224 (1988) 14, 28, 29

Bechtel v. Bohannon, 153 S.E. 316 (N.C. 1930) 17

Beck v. Prupis, 529 U.S. 494 (2000) 16

Blair v. Equifax Check Services, Inc., 181 F.3d 832 (7th Cir. 1999) 31

Bolin v. Sears, Roebuck & Co., 231 F.3d 970 (5th Cir. 2000) 32

Cement & Concrete Workers Dist. Council Welfare Fund v. Lollo, 148 F.3d 194 (2d Cir. 1998) 16

Chisolm v. TranSouth Financial Corp., 95 F.3d 331 (4th Cir. 1996) 18

Coopers & Lybrand v. Livesay, 437 U.S. 463 (1978) 30

Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336 (2005) 14, 15

Ellis v. Hale, 373 P.2d 382 (Utah 1962) 21

Field v. Mans, 516 U.S. 59 (1995) 14, 17

TABLE OF AUTHORITIES—Continued

Page

Freeman v. Venner, 120 Mass. 424 (1876)..................15

Greenville National Bank v. National Hardwood Co., 217 N.W. 786 (Mich. 1928)......17, 26

Grider v. Keystone Health Plan Central, Inc., No. 2001-cv-05641, 2006 U.S. Dist. LEXIS 93085 (E.D. Pa. Dec. 21, 2006)...............................32

Holmes v. Securities Investor Protection Corp., 503 U.S. 258 (1992)...*passim*

Ideal Steel Supply Corp. v. Anza, 373 F.3d 251 (2d Cir. 2004), *rev'd,* 126 S. Ct. 1991 (2006).....21, 34

Johnson v. Aronson Furniture Co., No. 96 C 117, 1998 U.S. Dist. LEXIS 14454 (N.D. Ill. Sept. 10, 1998)..32

Leff v. Olympic Federal Savings & Loan Ass'n, No. 86 C 3026, 1987 WL 12921 (N.D. Ill. June 19, 1987)..33

McCracken v. West, 17 Ohio 16 (1848).......................17

Mid Atlantic Telecom, Inc. v. Long Distance Services, Inc., 18 F.3d 260 (4th Cir. 1994).............18

Neder v. United States, 527 U.S. 1 (1999) 12, 25, 35

Pasley v. Freeman, 3 T.R. 51, 100 Eng. Rep. 450 (1789)..15

Patterson v. Mobil Oil Corp., 241 F.3d 417 (5th Cir. 2001)...18, 32

Peek v. Gurney, (1873) L.R. 6 H.L. 377......................17

Peterson v. H & R Block Tax Services, Inc., 174 F.R.D. 78 (N.D. Ill. 1997)..32

TABLE OF AUTHORITIES—Continued

Page

In re PolyMedica Corp. Securities Litigation, 432 F.3d 1 (1st Cir. 2005) 28

Regents of University of California v. Credit Suisse First Boston (USA), Inc., 482 F.3d 372 (5th Cir. 2007), *cert. denied*, No. 06-1341 (Jan. 22, 2008) 31

Ruffing v. Union Carbide Corp., 764 N.Y.S.2d 462 (App. Div. 2d Dep't 2003), *appeal dismissed*, 1 N.Y.3d 621 (2004) 22

Sandwich Chef of Texas, Inc. v. Reliance National Indemnity Insurance Co., 319 F.3d 205 (5th Cir.), *cert. denied*, 540 U.S. 819 (2003) 31

Sedima, S.P.R.L. v. Imrex Co., Inc., 473 U.S. 479 (1985) 4

Sikes v. Teleline, Inc., 281 F.3d 1350 (11th Cir.), *cert. denied*, 537 U.S. 884 (2002) 19, 28, 32

Stoneridge Investment v. Scientific-Atlanta, Inc., 128 S. Ct. 761 (2008) 26, 29

In re Synthroid Marketing Litigation, 188 F.R.D. 295 (N.D. Ill. 1999) 29, 32

Union Carbide Corp. v. Montell N.V., 9 F. Supp. 2d 405 (S.D.N.Y. 1998) 22

Van Swall v. Derschug, 257 N.Y.S. 206 (App. Div. 4th Dep't 1932) 26

VanDenBroeck v. CommonPoint Mortgage Co., 210 F.3d 696 (6th Cir. 2000) 18

TABLE OF AUTHORITIES—Continued

Page

Waste Management Holdings, Inc. v. Mowbray, 208 F.3d 288 (1st Cir. 2000) 31

Williamson v. Patterson, 106 S.W.2d 753 (Tex. Civ. App. 1937) 16, 20

STATUTES:

Racketeer Influenced and Corrupt Organizations Act, Pub. L. No. 91-452, tit. IX, 84 Stat. 941 (1970) .... *passim*

15 U.S.C. § 15(a) 11

18 U.S.C. § 1341 .... 3, 12, 24, 25, 34

18 U.S.C. § 1343 3

18 U.S.C. § 1961(1) 3, 12

18 U.S.C. § 1962(c) 3, 12

18 U.S.C. § 1964(c) .... *passim*

RULES

Fed. R. Civ. P. 23 30

Fed. R. Civ. P. 23(b)(3) 8

Fed. R. Civ. P. 23(f) 30

MISCELLANEOUS:

Thomas M. Cooley, *Cooley on Torts* (2d ed. 1888) 17, 20

TABLE OF AUTHORITIES—Continued

Page

W. Page Keeton, *The Ambit of a Fraudulent Representor's Responsibility,* 17 Tex. L. Rev. 1 (1938) ... 16

W. Page Keeton, et al., *Prosser & Keeton on the Law on Torts* (5th ed. 1984) ... 14, 15, 16, 22

Restatement (Second) of Agency (1958) ... 22

Restatement (Second) of Torts (1977) ... *passim*

Joseph Story, *Commentaries on Equity Jurisprudence* (13th ed. 1886) ... 16

Thomas E. Willging & Shannon R. Wheatman, *An Empirical Examination of Attorneys' Choice of Forum in Class Action Litigation* (Federal Judicial Center 2005) ... 30

BRIEF FOR MCKESSON CORPORATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS[1]

McKesson Corporation respectfully submits this brief as *amicus curiae* in support of petitioners.

INTEREST OF *AMICUS CURIAE*

McKesson Corporation is the nation's leading health care and information technology company, and is the largest pharmaceutical distributor in North America. McKesson is responsible for the distribution of one-third of the medicines used in North America, and supplies more than 25,000 healthcare locations across the country, ranging from Wal-Mart to the Department of Veteran Affairs to community pharmacies. McKesson employs 30,000 people, and is among the Global Fortune 500.

Although the Racketeer Influenced and Corrupt Organizations Act (RICO) serves an important purpose to deter and punish organized criminal conduct, RICO has been extended beyond congressional intent in some circumstances and

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[1] Letters from the parties consenting to the filing of this brief are being filed with the Clerk of the Court, pursuant to Rule 37.3(a). No counsel for a party authored this brief in whole or in part and no party or counsel for a party made a monetary contribution intended to fund the preparation or submission of the brief. No person other than *amicus curiae* or its counsel made a monetary contribution to the preparation or submission of this brief.

misused against businesses and other organizations because of the statute's treble damages provision. For example, the court of appeals in this case unnecessarily expanded the scope of liability under civil RICO when it held that a plaintiff seeking treble damages as a person who was "injured" "by reason of" the defendant's misrepresentation, need not allege that he relied on the purported misrepresentation by the defendant (or even received it). That ruling overrides an important statutory check on the award of treble damages that was established in the "by reason of" requirement, and will lead to further misuse of RICO.

The expansion of civil RICO into ordinary commercial transactions by suits filed on behalf of disappointed parties to such transactions, or by competitors and other individuals, has led to costly litigation and the potential for billions of dollars of liability. Again, this is particularly true in the context of class actions, where class certification often terminates cases, even where defendants have meritorious defenses, because the looming costs and possible consequences (oftentimes, no matter how remote) compel the defendant to settle. Because businesses in the health care and pharmaceutical industries have been the targets of such actions, *amicus curiae* has a substantial interest in the outcome of this case which will determine the scope of civil RICO liability in a variety of circumstances.

INTRODUCTION AND SUMMARY OF ARGUMENT

Congress enacted the Racketeer Influenced and Corrupt Organizations Act (RICO), Pub. L. No. 91-452, tit. IX, 84 Stat. 941, in 1970 to combat the growing influence of organized crime over the national economy. RICO thus lists in Section 1962 a series of prohibited activities, including making it unlawful for any person who is employed by or associated with an enterprise engaged in interstate commerce "to conduct or participate * * * in the conduct of" the affairs of that enterprise "through a pattern of racketeering activity." 18 U.S.C. § 1962(c). "Racketeering activity" is defined by RICO as any one of a host of listed acts, including any act that is indictable under dozens of federal criminal statutes such as the federal mail and wire fraud statutes, 18 U.S.C. §§ 1341, 1343. 18 U.S.C. § 1961(1).

RICO establishes various criminal penalties as well as public and private civil remedies. RICO allows, *inter alia*, for private civil actions to compensate victims of racketeering and provides that any person who was "injured in his business or property *by reason of* a violation of section 1962" may recover "threefold the damages he sustains" and attorneys' fees. *See* 18 U.S.C. § 1964(c) (emphasis added).

The availability of treble damages in a private civil action under RICO has led plaintiffs to attempt to invoke civil RICO in contexts entirely unrelated to

organized crime. *Sedima, S.P.R.L. v. Imrex Co., Inc.*, 473 U.S. 479, 500 (1985). Individuals and businesses motivated by the extraordinary remedy of treble damages frequently file suit against counterparties to commercial transactions, against competitors, and against other businesses, most often predicated on purported violations of the federal mail and wire fraud statutes. Pleading standards that adhere to the statutory requirements for recovery are thus necessary to prevent the misuse of civil RICO actions for treble damages as a means of procuring unwarranted settlements through threat of litigation against legitimate commercial enterprises.

The instant dispute involves one of those pleading standards, and poses the question whether a plaintiff who asserts he was "injured" "by reason of" a RICO violation, in order to recover treble damages under Section 1964(c) based upon mail fraud, must establish that he relied on the fraud and that such reliance was justified. *Amicus curiae* submits that a civil RICO plaintiff must make such a showing because, under well-settled applications of this Court's precedent, this condition follows from common law principles that undergird the "injured" "by reason of" requirement of civil RICO.

A.

The common law guides any interpretation of the private civil RICO remedy set forth in Section 1964(c). This Court relied on common law principles when it construed the meaning of the "by reason of" requirement of Section 1964(c) in *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258 (1992), and again in the recent case of *Anza v. Ideal Steel Supply Corp.*, 126 S. Ct. 1991 (2006). The Court explained that civil RICO was modeled after Section 4 of the Clayton Act and that the Court had previously construed the Clayton Act's near-identical language, in *Associated General Contractors of California, Inc. v. State Council of Carpenters*, 459 U.S. 519 (1983), to be "subject to constraints comparable to well-accepted common-law rules applied in comparable litigation." 459 U.S. at 533. A civil RICO action under Section 1964(c) that is predicated on federal mail fraud is most comparable to common law fraud litigation.

Learned treaties such as the *Restatement (Second) of Torts*, as well as the decisions of this Court applying those authorities, have long held that the common law requires a plaintiff in a fraud action to demonstrate not only his *own* reliance in order to recover for a misrepresentation, but also that that reliance was justifiable. A defendant is liable at common law only when it seeks to *influence* the plaintiff with its misrepresentation.

Respondents in the instant action cannot satisfy this standard because they not only failed to allege

any reliance on the alleged misrepresentation, but they in fact could not have relied on the alleged misrepresentation because they never even received it.

B.

Notwithstanding the well-settled common law principles of fraud, a handful of federal courts have held that a plaintiff may recover treble damages under Section 1964(c) as a person who was "injured" "by reason of" alleged mail or wire fraud merely by showing that some third party relied on the alleged misrepresentation or fraudulent omission. But the common law creates no such exception to justifiable reliance by the plaintiff in fraud cases. The *Restatement (Second) of Torts* provides that recovery by a plaintiff is allowed based on third party receipt of the alleged fraud only where the misrepresentation is communicated by the third party to the plaintiff, the plaintiff relies on the misrepresentation, and the defendant had expected that its misrepresentation would be repeated to the plaintiff and that the plaintiff would rely upon it. Other exceptions to the showing of justifiable reliance directly by the plaintiff are limited to where there is a special relationship between the plaintiff and a third party that relied upon the misrepresentation, such as the relationship between a principal and an agent or a parent and a child.

The court of appeals was wrong in its view that, because the federal mail fraud statute authorizes prosecution by the government under Section 1341 for a "scheme" to defraud without having to prove injury or reliance, the same standard applies to a private action for treble damages under the differently worded civil RICO provision Section 1964(c). A "scheme" to defraud is nothing more than an uncompleted fraud which does not cause injury and, by definition, no treble damages can be recovered under civil RICO in such circumstances because the plaintiff was not "injured" as required by Section 1964(c).

Respondents attempt to create a presumption of reliance here based on their participation in a public auction, but no such presumption applies outside the field of securities litigation. And, even where the Court has presumed reliance in securities cases, respondents here still could not prevail because such a fraud on the market theory requires that the defendant have made a public material misstatement. Reliance is presumed only in such circumstances because it is assumed that the securities markets will automatically misadjust to the misinformation, making individualized reliance unnecessary, but no comparable circumstances existed here.

C.

The threat of class-wide civil RICO damages, particularly when they would be trebled under 18 U.S.C. § 1964(c), poses a real obstacle to major corporations across all industries who have become targets of class action lawsuits that transform ordinary fraud allegations into civil RICO actions. Such lawsuits often force legitimate businesses to forgo the possibility of defending against such fraud allegations on the merits and to, instead, settle unsubstantiated claims because of the potentially staggering liability and litigation expenses that are at risk for even the most meritless claim.

The requirement of justifiable reliance to recover treble damages as a person "injured" "by reason of" a RICO fraud provides an important protection against abusive litigation. It ensures that only those directly injured by racketeering can recover as Congress intended and it precludes plaintiffs from maintaining costly, untenable claims at early stages of litigation in an attempt to obtain damages from alleged derivative harms. Also, the justifiable reliance requirement often is considered an individualized determination in the context of class actions that precludes certification under Rule 23(b)(3) of the Federal Rules of Civil Procedure. Without the justifiable reliance requirement, class actions will proliferate and impose a great burden on the national economy.

Finally, even if the Court were to choose to depart from common law principles and allow recovery of treble damages under 18 U.S.C. § 1964(c) where a third party, rather than the plaintiff, relied upon the misrepresentation, such recovery should be limited to the circumstance where the plaintiff is the most immediate victim with the only possibility of recovery. Such an approach would, at least, limit derivative liability because no other party could claim a more direct injury due to the purported fraud.

ARGUMENT

CONGRESS INCORPORATED COMMON LAW PRINCIPLES, INCLUDING JUSTIFIABLE RELIANCE BY THE PLAINTIFF, INTO PRIVATE CIVIL RICO ACTIONS PREDICATED ON MAIL FRAUD

Congress specified that a person can recover treble damages in a private civil RICO action under 18 U.S.C. § 1964(c), only if the plaintiff was "injured in his business or property by reason of" a RICO violation. Where the alleged RICO violation is predicated on mail fraud, a plaintiff is "injured" "by reason of" the defendant's alleged mail fraud according to common law fraud principles only if the plaintiff justifiably relied on the defendant's fraudulent conduct.

A. This Court's Longstanding Interpretation Of The "By Reason Of" Requirement In The Civil RICO Cause Of Action, 18 U.S.C. § 1964(c), Relies On The Common Law

1. Interpretation of Section 1964(c) is guided by the common law principles applicable to "comparable litigation," and a Section 1964(c) civil RICO cause of action predicated on mail fraud is comparable to a common law fraud action

a. Under this Court's well-settled precedent, the common law principles of "comparable litigation" are incorporated into civil RICO actions under Section 1964(c). In *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258 (1992), and again in *Anza v. Ideal Steel Supply Corp.*, 126 S. Ct. 1991 (2006), the Court relied on common law principles and construed the "injured" "by reason of" requirement of Section 1964(c) to mandate that a plaintiff demonstrate that the civil RICO violation proximately caused his injury.

The *Holmes* Court reasoned that "common-law principles" must undergird interpretation of Section 1964(c), in part, because that provision cannot be construed so that civil RICO "allow[s] all factually injured plaintiffs to recover." *Holmes*, 503 U.S. at 266, 267. The Court explained in *Holmes* "that Congress modeled § 1964(c) on the civil-action provision of the federal antitrust law, § 4 of the Clayton Act." Section 4 provides that an antitrust plaintiff seeking treble damages must establish that he was "injured" "by

reason of anything forbidden in the antitrust laws." 15 U.S.C. § 15(a). Thus, when the *Holmes* Court was called upon to interpret the "injured" "by reason of" requirement of civil RICO, it emphasized that the Court already had construed that near identical language of the Clayton Act in *Associated General Contractors of California, Inc. v. State Council of Carpenters*, 459 U.S. 519 (1983), to require federal antitrust plaintiffs to meet various common law requirements. *Holmes*, 503 U.S. at 267-268; *see also Anza*, 126 S. Ct. at 1996.

The Court's decisions in *Associated General Contractors*, *Holmes*, and most recently *Anza* were guided by the understanding that "Congress simply assumed" that the broad treble damages remedies provisions in the Clayton Act and in RICO "would be subject to constraints comparable to well-accepted common law rules applied in comparable litigation." *Associated Gen. Contractors*, 459 U.S. at 533; *see also Holmes*, 503 U.S. at 267; *Anza*, 126 S. Ct. at 1996. Accordingly, the Court has held that "a number of judge-made rules [that] circumscribed the availability of damages recoveries in * * * tort" are incorporated into the "injured" "by reason of" requirement for treble damages under the Clayton Act and civil RICO. *Associated Gen. Contractors*, 459 U.S. at 532, 535; *see also Holmes*, 503 U.S. at 267; *Anza*, 126 S. Ct. at 1996.

b. The court of appeals in the instant case ignored the impact of this well-settled precedent. The court restricted its analysis to whether a proximate

cause standard was satisfied, and did not consider whether common law principles also require that a plaintiff, who alleges civil RICO predicated on a fraud-based racketeering activity, must meet the common law fraud requirement of justifiable reliance by the plaintiff. Pet. App. 4a. The court's failure to impose that common law requirement is contrary to this Court's mandate that the "injured" "by reason of" language used by Congress imposes the "well-accepted common-law rules" that would be "applied in comparable litigation." *Associated Gen. Contractors*, 459 U.S. at 533.

Where, as here, a plaintiff seeks treble damages under civil RICO Section 1964(c) based on alleged injury "by reason of" racketeering in violation of Section 1962 predicated on a pattern of mail fraud in violation of 18 U.S.C. § 1341, the "comparable litigation" that guides this Court's analysis is a common law fraud action. This Court already has considered the question with respect to federal criminal mail fraud actions brought directly under 18 U.S.C. § 1341 and held in *Neder v. United States*, 527 U.S. 1 (1999), that such criminal actions are comparable to "actionable 'fraud' [that] ha[s] a well-settled meaning at common law." *Id*. at 22. Civil RICO actions like the instant case, which are based on alleged injury "by reason of" underlying federal mail fraud, are, *a fortiori*, more comparable to common law fraud than the criminal prosecution at issue in *Neder*. Indeed, *Anza* and *Holmes* demonstrate that imposition of common law principles in civil RICO

actions that circumscribe the recovery of treble damages are derived from RICO Section 1964(c)'s "injury" and "by reason of" requirements, *Anza*, 126 S. Ct. at 1996; *Holmes*, 503 U.S. at 268, and not from the predicate racketeering activity.

2. Justifiable reliance by the plaintiff is a necessary component of causation in any common law fraud action

a. Common law principles have long required a plaintiff to demonstrate not only *his own* reliance on the alleged misrepresentation or fraudulent omission, but also that his reliance was *justifiable*. The *Restatement (Second) of Torts* explains that "Liability for Fraudulent Misrepresentation" requires a plaintiff to suffer "pecuniary loss caused to him by his justifiable reliance upon the misrepresentation." *Restatement (Second) of Torts* § 525 (1977). Accordingly, the defendant is "subject to liability" only if the plaintiff "justifiably relies upon the truth of the matter misrepresented * * *." *Id.* § 546. The comments to Section 546 of the *Restatement* further explain that "[f]or a misrepresentation to be a cause in fact of the pecuniary loss * * *, the plaintiff must have relied upon the misrepresentation in incurring the loss." *Id.* § 546 cmt. b; *see also id.* § 537 cmt. a ("The recipient of a fraudulent misrepresentation can recover from the maker for his pecuniary loss only if he in fact relies upon the misrepresentation in acting or in refraining from action, and his reliance is a substantial factor in bringing about the loss.").

These sections of the *Restatement (Second) of Torts* constitute authoritative statements of the common law. In *Field v. Mans*, 516 U.S. 59, 70 (1995), the Court described the *Restatement (Second) of Torts* as "the most widely accepted distillation of the common law of torts." Indeed, citing to the *Restatement (Second) of Torts* in other contexts, this Court has understood common law fraud to impose liability "'for pecuniary loss caused' to one who justifiably relies upon th[e] misrepresentation." *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 343 (2005) (quoting *Restatement (Second) of Torts* § 525); *see also Basic Inc. v. Levinson*, 485 U.S. 224, 243 (1988) ("agree[ing]" that reliance is an element of a Rule 10b-5 cause of action based upon the fact "that reliance is and long has been an element of common-law fraud") (citing *Restatement (Second) of Torts* § 525 and W. Page Keeton, et al., *Prosser & Keeton on the Law on Torts* § 108 (5th ed. 1984)).

Relying on the *Restatement (Second) of Torts*, the Court in *Field v. Mans* thus held that the Bankruptcy Code's exception for the discharge of debts due to "false pretenses, a false representation, or actual fraud" requires that a plaintiff demonstrate his own justifiable reliance upon the fraudulent misrepresentation, *Field*, 516 U.S. at 61 (quoting 11 U.S.C. § 523(a)(2)(A)), even though the statutory text neither imposes a reliance requirement nor specifies what degree of reliance is required, *id.* at 66. Like this Court's construction of Section 1964(c) in *Holmes* and *Anza*, the *Field* Court concluded that "there is no reason to doubt Congress's

intent to adopt a common-law understanding of the terms it used," *id.* at 70, and explained that a "'plaintiff's reliance on the misrepresentation must be justifiable * * *.'" *Id.* at 70-71 (quoting *Restatement (Second) of Torts* § 545A cmt. b); *see also id.* at 70-72 (explaining by example why a plaintiff's justifiable reliance on the purported fraudulent misrepresentation is required); *see also Dura Pharm.*, 544 U.S. at 343-344 ("[T]he common law has long insisted that a plaintiff in such a case show not only that had he known the truth he would not have acted but also that he suffered actual economic loss.") (citing *Pasley v. Freeman*, 3 T.R. 51, 65, 100 Eng. Rep. 450, 457 (1789), and *Freeman v. Venner*, 120 Mass. 424, 426 (1876)).

Other learned treatises are in accord with the *Restatement (Second) of Torts*. *Prosser and Keeton on the Law of Torts* explains that the "elements of the tort cause of action in deceit" include "[j]ustifiable reliance upon the representation on the part of the plaintiff" and "[d]amage to the plaintiff, resulting from such reliance." Keeton, *supra*, at 728.[2] It makes

[2] The common law thus limited recovery to those who directly relied upon the purported fraudulent representation. As Professor W. Page Keeton explained: "The further removed a person is from the misstatement, the less the likelihood of reliance thereon, and it may be that justice cannot be administered successfully so as to permit anyone to recover who could prove reliance thereon." W. Page Keeton, *The Ambit of a Fraudulent Representor's Responsibility*, 17 Tex. L. Rev. 1, 8 (1938). Accordingly, "[t]here is * * * some justification for not holding a person liable to anyone he happens to cheat merely because he intended to cheat some one * * * ." *Ibid.*

clear that the common law dictates that "[n]ot only must there be reliance but the reliance must be justifiable under the circumstances." *Id.* at 749. Likewise, Justice Story's *Commentaries on Equity Jurisprudence* states that civil fraud requires that a plaintiff "must have been misled to his prejudice or injury." 1 Joseph Story, *Commentaries on Equity Jurisprudence* § 203, at 227 (13th ed. 1886).[3]

b. The legal theories articulated in these treatises have been widely applied in courtrooms across this country for more than 100 years. State and lower federal courts preclude recovery in fraud-based actions where a plaintiff fails to demonstrate his *own* justifiable reliance on the purported misrepresentation. *See, e.g.*, *Cement & Concrete Workers Dist. Council Welfare Fund v. Lollo*, 148 F.3d 194, 196 (2d Cir. 1998) ("We hold that a plaintiff does not establish the reliance element of fraud for purposes of ERISA or New York law by showing only that a third party relied on a defendant's false statements."). "A person making a representation *is only accountable for its truth or honesty to the very person or persons whom he seeks to influence* * * * ." *Williamson v. Patterson*, 106 S.W.2d 753, 756 (Tex. Civ. App. 1937) (quoting

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[3] This Court has looked to common principles in other civil RICO contexts, including in *Beck v. Prupis*, 529 U.S. 494, 500 (2000), where the Court "turn[ed] to the well-established common law of civil conspiracy," 529 U.S. at 500, and relied on authorities such as the *Restatement (Second) of Torts* and earlier editions of *Prosser & Keeton on the Law on Torts*, *id.* at 501.

Thomas M. Cooley, *Cooley on Torts* 493 (2d ed. 1888)) (emphasis added); *Greenville Nat'l Bank v. National Hardwood Co.*, 217 N.W. 786, 787 (Mich. 1928) (same).[4]

The common law requirement that a plaintiff's reliance be justifiable also is widely applied. This Court, in *Field*, demonstrated that among the 46 States requiring reliance in a fraud-based common law action, 36 of those States require that the plaintiff's reliance upon the misrepresentation be justifiable. *Field*, 516 U.S. at 72-74 and nn.10-12 (citing cases).[5] Thus, even to the extent stray rulings require something less (or more) than a plaintiff's own justifiable reliance, those few decisions would not reflect "the dominant consensus of common-law jurisdictions" on which this Court relies. *Id.* at 70 n.9.

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[4] The common law often further restricts liability to the *intended* recipients of the misrepresentation. The leading case on the scope of liability for a fraudulent misrepresentation, *Peek v. Gurney*, (1873) L.R. 6 H.L. 377, demonstrates that a plaintiff may not be able to recover even if he hears a misrepresentation, relies upon it, and suffers damage, where the defendant never intended the plaintiff to rely upon the misrepresentation. *See also Bechtel v. Bohannon*, 153 S.E. 316, 316-317 (N.C. 1930) ("An essential element of a cause of action for the recovery of damages for false and fraudulent representations is that the representations alleged to be false and fraudulent were made with intent that the plaintiff shall act * * * ."); *McCracken v. West*, 17 Ohio 16, 26 (1848) (same).

[5] Of the remaining 10 States, 5 required that the plaintiff show only his own reliance, and 5 mandated that the plaintiff's reliance be reasonable. *Id.* at 72-73.

Finally, as petitioners demonstrate (Pet. Br. 29-35), the clear majority of the federal courts of appeals that have considered the issue have required that a civil RICO plaintiff not only plead reliance, but that he also demonstrate his *own* reliance on the purported misrepresentation. *See, e.g.*, *Chisolm v. TranSouth Fin. Corp.*, 95 F.3d 331, 337 (4th Cir. 1996) (civil RICO plaintiffs must "allege both that they detrimentally relied in some way on the fraudulent mailing and that the mailing was a proximate cause of the alleged injury to their business or property") (internal citation omitted);[6] *Patterson v. Mobil Oil Corp.*, 241 F.3d 417, 419 (5th Cir. 2001) (each member of putative RICO class action "must then prove reliance upon * * * alleged fraud"); *VanDenBroeck v. CommonPoint Mortgage Co.*, 210 F.3d 696, 701 (6th

[6] The Fourth Circuit was described by the court below as a jurisdiction that allows the reliance requirement to be satisfied by a third party, *see* Pet. App. 7a (citing *Mid Atlantic Telecom, Inc. v. Long Distance Services, Inc.*, 18 F.3d 260, 263-264 (4th Cir. 1994)), but that is not so. The Fourth Circuit's subsequent decision in *Chisolm* makes clear that direct reliance by a plaintiff is required by that court (a rule that was in place both before and after the anomalous *Mid Atlantic Telecom* decision). Moreover, *Mid Atlantic Telecom* is no longer good law because that fact pattern (unlike the one in the instant case) clearly could not survive application of *Anza*. In *Mid Atlantic Telecom*, a competitor sued a rival company on the ground that the rival had defrauded customers (by claiming to offer lower prices for telephone services when it was in fact not offering them) which took customers away from its competitors. Just as in *Anza*, however, there can be no proximate cause because the customers, not the competitors, were the direct victims of the fraud. *Anza*, 126 S. Ct. at 1998.

Cir. 2000) (alleged misrepresentation must have been "calculated or intended to deceive persons of reasonable prudence and comprehension, and must also show that plaintiffs in fact relied upon that material misrepresentation"); *Appletree Square I, Ltd. P'ship v. W.R. Grace & Co.*, 29 F.3d 1283, 1286 (8th Cir. 1994) ("In order to establish injury to business or property 'by reason of ' a predicate act of mail or wire fraud, a plaintiff must establish detrimental reliance on the alleged fraudulent acts."); *Sikes v. Teleline, Inc.*, 281 F.3d 1350, 1360 (11th Cir.) ("when a plaintiff brings a civil RICO case predicated upon mail or wire fraud, he must prove that he was a target of the scheme to defraud and that he relied to his detriment on misrepresentations made in furtherance of that scheme") (internal quotations omitted), *cert. denied*, 537 U.S. 884 (2002).

3. The ruling below violates well-settled principles of common law fraud

In the instant case, respondents are purchasers of tax liens from a county and contend that petitioners, who also purchased tax liens from the county, submitted false affidavits to the county and that the county relied on the falsehoods when it awarded additional liens to petitioners at auction. Respondents thus claim harm because petitioners obtained more liens than petitioners were entitled to, which meant that respondents obtained fewer liens.

The district court correctly ruled that respondents lack standing to bring a civil RICO action in these circumstances, and dismissed the claim. The court of appeals erred when it reversed that ruling and held that respondents have standing even though they were not the recipients of, and did not rely on, any alleged misrepresentations. Indeed, as petitioners demonstrate (Pet. Br. 36-37), nothing in respondents' allegations even remotely demonstrates that petitioners sought to influence respondents in any way by petitioners' submission to the county of the purportedly false affidavits. *Williamson*, 106 S.W.2d at 756 (quoting Cooley, *supra*, at 493).

B. The Common Law Does Not Support The Judgment Below Allowing Respondents To Seek Treble Damages Without Any Showing That They Directly And Justifiably Relied On The Alleged Fraud

1. A third party's reliance on a fraud defendant's purported misrepresentation does not satisfy the common law fraud reliance requirement

a. Contrary to the well-settled common law principles analyzed above, a handful of federal courts have held that a plaintiff seeking treble damages based on a predicate of mail or wire fraud racketeering can satisfy civil RICO's requirement of injury "by reason of" the predicate violation, by demonstrating reliance of a third party, rather than direct reliance of the plaintiff, on the alleged

misrepresentation or fraudulent omission. *See, e.g.*, *Ideal Steel Supply Corp. v. Anza*, 373 F.3d 251 (2d Cir. 2004), *rev'd*, 126 S. Ct. 1991 (2006).

The common law does not permit such a reading. As discussed above (*see* pages 13-18), the *Restatement (Second) of Torts* and other common law authorities, including the rulings of this Court, dictate that plaintiffs, such as respondents, who seek to recover under common law fraud must demonstrate their own justifiable reliance on the fraudulent conduct. The court of appeals below was wrong to fashion an exception for a plaintiff merely because he claims that he was the "direct *victim*" of the misrepresentation, but where he was not the "direct *recipient*" (or was not a recipient at all, as in the instant case) "of the false statement." Pet. App. 7a (emphasis in original).

The common law of fraud allows recovery only in exceedingly narrow circumstances where a third party, rather than the plaintiff, is the original recipient of the alleged misrepresentation. The *Restatement (Second) of Torts* explains that recovery for a "Representation Made to a Third Person" is available only where (1) a misrepresentation is made to a third party, (2) the misrepresentation is communicated by the third party to the plaintiff, (3) the plaintiff relies upon the transmitted misrepresentation, *and* (4) the defendant had anticipated that the plaintiff would receive and rely upon the misrepresentation that the defendant had communicated to the third party. *Restatement (Second) of Torts* § 533; *see also Ellis v. Hale*, 373 P.2d

382, 385 (Utah 1962) (same) (citing the *Restatement (Second) of Torts* § 533).

Prosser and Keeton on the Law on Torts sets forth the same limited exception to the rule that a plaintiff must establish that he directly received and relied on the misrepresentation from the defendant. *Keeton*, *supra*, at 743-745. It explains that the rule of firsthand receipt and reliance by the plaintiff "has been followed by numerous American courts" without any exception that allows recovery based on reliance of a third party, including "in cases involving * * * similar remote investors, an assignee or subpurchaser from the one originally dealt with, casual bystander who overhears but is not expected to take action, and others who were not intended to be affected by the representation, with no special reason to expect them to act upon it." *Id.* at 743 (footnotes citing cases and emphasis omitted).

Along similar lines, a misrepresentation made to a third party and relied upon by that third party creates liability to a plaintiff derivatively harmed only where the third party is an agent of the injured plaintiff as a principal, *see Restatement (Second) of Agency* § 315 (1958) (allowing suit "whether the fraud is practiced upon the agent or upon the principal"), or in other cases that involve special relationships, such as a parent and a child, *see, e.g.*, *Ruffing v. Union Carbide Corp.*, 764 N.Y.S.2d 462 (App. Div. 2d Dep't 2003) (parent-child relationship), *appeal dismissed*, 1 N.Y.3d 621 (2004); *Union Carbide Corp. v. Montell*

N.V., 9 F. Supp. 2d 405, 411-412 (S.D.N.Y. 1998) (valuation by an appraiser).

Such circumstances are not present in the instant case. Respondents were not in an agency or other special relationship with the county, who was the recipient of and relied on the alleged misrepresentations. Pet. App. 7a. And no leading treatise contemplates the third-party reliance of the sort the court of appeals endorsed. Pet. App. 7a ("A scheme that injures D by making false statement through the mail to E is mail fraud, and actionable by D through RICO if the injury is not derivative of someone else's.").

b. Any expansion of the narrow common law exception for third-party reliance would undermine the common law requirement that a fraud plaintiff's reliance be *justifiable*.

In the few circumstances where the common law recognizes recovery based on third-party reliance, either the plaintiff *himself* justifiably relied upon the transmitted misrepresentation or a third party in an *agency* or other *special* relationship with the plaintiff justifiably relied on the misrepresentation (proof of whether the agent's or parent's reliance was justifiable was charged to the ultimate plaintiff). But third-party reliance of the sort endorsed by the court of appeals makes no such inquiry into whether the plaintiff's actions were justifiable, and there would be no basis to impute the justifiability of a third party's reliance (here the reliance by the county) to

the plaintiff where there is no agency or other special relationship.[7]

2. Allowance of "scheme" liability for criminal prosecution under Section 1341 does not eliminate the common law reliance requirement for a person seeking civil RICO treble damages under Section 1964(c) for an alleged injury "by reason of" predicate mail fraud

The court of appeals also concluded that it "is unnecessary to show that the false statement was made to the victim" in a civil RICO action because the federal "mail fraud statute, 18 U.S.C. § 1341, defines a fraudulent *scheme* rather than a particular false statement, as the crime." Pet. App. 7a (emphasis in original). But that argument is wrong for two reasons.

First, the focus on "scheme" to defraud in Section 1341 conflates criminal liability under that provision with civil remedies under the differently worded civil

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[7] Nothing in the text of Section 1964(c) demonstrates *any* intent by Congress to depart from the common law requirement that a plaintiff in a fraud action demonstrate his own justifiable reliance on the alleged misrepresentation. By specifying that "[a]ny person" may recover treble damages *only* if he meets the Section 1964(c) requirement that he was injured "by reason of" the predicate RICO violation, including in fraud cases, Congress imposed the common law firsthand reliance requirement on *all* civil RICO fraud plaintiffs.

RICO provision, 18 U.S.C. § 1964(c), which is at issue here. This Court has explicitly recognized that a "scheme" to defraud for purposes of Section 1341 is distinct from "the completed fraud," *Neder*, 527 U.S. at 25, and that when Congress included "scheme" in the federal criminal mail fraud statute it could not have intended to include reliance or damages because the government need not demonstrate any injury in Section 1341 prosecutions. *Ibid*.

By contrast, when Congress enacted civil RICO it specified that a civil action for treble damages under Section 1964(c) is available only to a plaintiff who is "injured in his business or property by reason of a violation of section 1962." 18 U.S.C. § 1964(c). Thus, Congress mandated that a civil RICO plaintiff under Section 1964(c) prove injury. Congress also mandated that such a civil RICO plaintiff meet the "by reason of" standard. Congress thereby made clear that not all violations of Section 1962 can serve as predicates for a civil RICO action under Section 1964(c). In the case of mail fraud in violation of Section 1341, a racketeering pattern of such conduct can constitute a violation of Section 1962, but it cannot serve as a predicate for a civil RICO action under Section 1964(c) unless the "injured" "by reason of" standard is met. A "scheme" to defraud cannot, by definition, meet that standard because a "scheme" alone causes no injury since it constitutes nothing more than an uncompleted fraud.

Second, even if a "scheme" were actionable under Section 1964(c), common law fraud rejects liability

based upon the existence of a mere scheme when the plaintiff fails to rely on a misrepresentation by the defendant. *See* pages 13-18 *supra*. Accordingly, courts have held that "misrepresentations made to accomplish the purpose of the scheme" impose no liability where "[t]he plaintiff fails to show that he is one of the class to which the representations were intended to be addressed * * * ." *Van Swall v. Derschug*, 257 N.Y.S. 206, 207 (App. Div. 4th Dep't 1932). Without having relied upon a misrepresentation, a plaintiff's "allegations in relation to such a scheme are therefore irrelevant." *Ibid.* The existence of a scheme does not matter because the "controlling question" is "[w]hom did the defendants intend to influence by their representations." *Greenville Nat'l Bank*, 217 N.W. at 787. Here, respondents did not allege that petitioners had any intent to influence them, but rather the allegation was that the alleged fraud was intended to influence the county.

The mere invocation of "scheme" liability does not transform derivative injuries into primary ones. In *Anza*, the Second Circuit described the purported racketeering activity as a fraudulent tax "scheme," but that characterization provided plaintiffs with no safe harbor from the Court's requirement that the alleged injury directly flow from the defendant's misrepresentation. *Anza*, 126 S. Ct. at 1995; *see also id.* at 1996 (describing the alleged racketeering activity in *Holmes* as a "scheme"). *Cf. Stoneridge Investment v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 770 (2008) (rejecting attempt to obviate reliance

requirement merely because of "scheme liability" because such liability, to be actionable, still requires a public misrepresentation which can be relied upon).

3. A presumption of reliance has no place in common law fraud, and thus is inapplicable to civil RICO predicated on mail fraud

As a last resort, respondents have attempted to somehow meet the reliance requirement by asserting that they relied on the "integrity of the allocation process" for the tax liens that was used by the county. Br. in Opp. 29. But that assertion is beside the point.

If fraud-based liability were to be presumed because of the absence of integrity in the county's allocation process (which it cannot be), then the only party that could plausibly be liable for fraud is the county. Such a claim and presumption would go to the county's representation that its process for allocating the tax liens would be run in a fair manner and the county's inducing respondents to participate in that process.

Indeed, what respondents ask this Court to do is to presume fraud-based reliance where a plaintiff relies upon the integrity of a quasi-market and suffers some loss. But even in the narrow circumstances where the Court has presumed reliance, such as in the field of securities where a defendant commits "fraud on the market" by publicly making material misstatements that affect the price

of a publicly traded security in a highly efficient market, a presumption applies only where the defendant has made publicly disseminated misrepresentations that will be relied upon and thus reflected in the now miscalculated value of the security. *Basic*, 485 U.S. at 247.[8] And a plaintiff seeking to invoke that fraud-on-the-market theory must demonstrate, rather than just presume, that the market is efficient. *In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1 (1st Cir. 2005) (demonstrating rigorous standards required to prove an efficient market).

Respondents have made no such allegation here. In fact, it would have been patently nonsensical for petitioners to have made such a misrepresentation to induce respondents to participate in the auctions because petitioners received *no* benefit from respondents' participation; according to respondents

[8] The fraud-on-the-market theory in the securities context relies on the perfect efficiency of the securities markets, where all material information is almost instantaneously reflected in the price of the securities. *Sikes v. Teleline, Inc.*, 281 F.3d 1350, 1363 (11th Cir.), *cert. denied*, 537 U.S. 884 (2002) ("The securities market presents a wholly different context than a consumer fraud case, and neither this circuit nor the Supreme Court has extended a presumption of reliance outside of securities cases."). There is no reason to apply such a theory in civil RICO actions where there is no evidence that the quasi-markets that often underlie civil RICO actions demonstrate the perfect efficiency of the Nation's securities markets.

themselves, the point of the alleged fraud by petitioners was to dilute respondents' involvement.[9]

C. The Common Law Reliance Requirement Ensures That Civil RICO Predicated On Mail Fraud Does Not Become A Business Tort Statute For Disappointed Competitors Or Parties To Commercial Contracts

1. Civil RICO mail fraud class actions will proliferate if plaintiffs are not required to prove their own justifiable reliance

a. Numerous Fortune 500 companies, including those in the pharmaceutical industry where *amicus curiae* is a major distributor, have been targets of plaintiffs who transform ordinary fraud allegations into civil RICO actions because of the extraordinary relief of trebled damages and attorneys' fees available under civil RICO. Although businesses often prevail on the merits against individual fraud claims, or even those brought by a small group of plaintiffs, the stakes change significantly when plaintiffs attempt to certify a class under Rule 23 of the Federal Rules of Civil Procedure and seek trebled damages for every class member.

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[9] Even in the context of securities litigation, respondents' claims would be infirm. *Stoneridge Investment v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761 (2008) (holding that potential fraudulent statements cannot provide a basis for liability if the investing public did not rely upon them).

The threat of class-wide treble damages under civil RICO often forces legitimate businesses to forgo the possibility of defending against the claim on the merits and to, instead, settle unsubstantiated claims because of the potentially staggering liability and litigation expenses that are at risk for even the most meritless claim. This Court has recognized that "[c]ertification of a large class may so increase the defendant's potential damages liability and litigation costs that he may find it economically prudent to settle and to abandon a meritorious defense." *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 476 (1978). Indeed, the empirical evidence demonstrates that class actions that are certified almost always settle. *See* Thomas E. Willging & Shannon R. Wheatman, *An Empirical Examination of Attorneys' Choice of Forum in Class Action Litigation* 48 (Federal Judicial Center 2005) ("It is often said that most or even all class actions settle. Data from the current study as well as the earlier [1996] FJC study reveal an important qualification for this statement: Almost all certified class actions settle."). Moreover, in cases where there is a risk of even being associated with a class-wide accusation of federal "racketeering," there are strong reasons for out-of-court settlement of unsubstantiated claims.[10]

[10] Rule 23(f) of the Federal Rules of Civil Procedure provides a possible avenue to interlocutory review of class certification, but courts of appeals do not grant such requests with any regularity despite their recognition that certification

(Continued on following page)

b. The question whether and to what degree a plaintiff must demonstrate justifiable reliance on a defendant's alleged fraud in order to maintain a civil RICO action predicated on mail fraud is a particularly important question in class actions.

Damages class actions certified pursuant to Rule 23(b)(3) of the Federal Rules of Civil Procedure require "that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members." This requirement often precludes certification of a class action when plaintiffs must prove justifiable reliance. *See Sandwich Chef of Texas, Inc. v. Reliance Nat'l Indem. Ins. Co.*, 319 F.3d 205, 220 (5th Cir.) ("A [RICO] class cannot be certified when evidence of individual reliance will be necessary."), *cert. denied*,

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"places 'insurmountable pressure' on a defendant to settle, even where the defendant has a good chance of succeeding on the merits." *Regents of Univ. of California v. Credit Suisse First Boston (USA), Inc.*, 482 F.3d 372, 379 (5th Cir. 2007), *cert. denied,* No. 06-1341 (Jan. 22, 2008). Some courts of appeals, in conflict with the decisions of other circuits, have imposed stringent standards on Rule 23(f) petitions, so that economic pressure and the fact that the decision might otherwise evade review are but some of many components in the decisionmaking process. *See, e.g.*, *Waste Mgmt. Holdings, Inc. v. Mowbray*, 208 F.3d 288, 294 (1st Cir. 2000) (focusing on criteria other than the fact that defendant may succumb to settlement demands); *Blair v. Equifax Check Servs., Inc.*, 181 F.3d 832, 834-835 (7th Cir. 1999) (same). Indeed, courts of appeals have admonished that they "intend to exercise [their] discretion judiciously" because appellate review of certification orders "are disruptive, time-consuming, and expensive." *Mowbray*, 208 F.3d at 294.

540 U.S. 819 (2003); *Patterson*, 241 F.3d at 419 (the individualized reliance findings required in a civil RICO action precluded certification); *Bolin v. Sears, Roebuck & Co*., 231 F.3d 970, 978 (5th Cir. 2000) ("the individual findings of reliance necessary to establish RICO liability and damages preclude not only (b)(2) certification of this class under RICO, but (b)(3) certification as well."); *Sikes*, 281 F.3d at 1364 (because RICO class members needed to demonstrate reliance, "[i]ndividual issues will therefore predominate over common issues.").

Without a requirement that a civil RICO plaintiff prove his own justifiable reliance in a case predicated on mail fraud, these class actions will proliferate and impose greater burdens on the national economy. No industry is immune from these suits, as these actions already have been indiscriminately filed against some of the nation's most important sectors, such as health care companies, health maintenance organizations, financial services companies, and ordinary businesses in jurisdictions which do not require a showing of reliance. *See, e.g.*, *Grider v. Keystone Health Plan Cent., Inc.*, No. 2001-cv-05641, 2006 U.S. Dist. LEXIS 93085 (E.D. Pa. Dec. 21, 2006) (class of thousands of doctors brought action against health maintenance organization); *In re Synthroid Mktg. Litig*., 188 F.R.D. 295 (N.D. Ill. 1999) (nationwide class certified against pharmaceutical industry); *Johnson v. Aronson Furniture Co*., No. 96 C 117, 1998 U.S. Dist. LEXIS 14454 (N.D. Ill. Sept. 10, 1998) (class of all retail customers); *Peterson v. H & R Block Tax Servs., Inc*.,

174 F.R.D. 78 (N.D. Ill. 1997) (statewide class against tax preparer); *Leff v. Olympic Fed. Sav. & Loan Ass'n*, No. 86 C 3026, 1987 WL 12921 (N.D. Ill. June 19, 1987) (statewide class certified against lender).

2. Even if the Court chose to depart from common law principles, any allowance for third-party reliance should preclude recovery for derivative injuries

a. Adoption of a third-party reliance exception like the one embraced by the court of appeals would represent a significant retreat from this Court's decisions in *Holmes* and *Anza*. In both those decisions, the Court held that there must be "some direct relation between the injury asserted and the injurious conduct alleged." *Holmes*, 503 U.S. at 268; *Anza*, 126 S. Ct. at 1996.[11]

Rather than focus on whether there was a direct relation between the injury and the misrepresentation as required by that precedent, however, the court of appeals below concluded that respondents, as the "immediate and principal losers," should be capable of bringing suit. Pet. App. 7a. But being the immediate

[11] The only court of appeals other than the court below which allows third-party reliance to satisfy Section 1964(c)'s "by reason of" requirement is the same court whose last exposition of that rule (which was relied upon heavily by the court below, *see* Pet. App. 7a) was reversed by this Court in *Anza*. *See, e.g.*, *Ideal Steel Supply Corp. v. Anza*, 373 F.3d 251 (2d Cir. 2004), *rev'd*, 126 S. Ct. 1991 (2006).

and principal loser does not necessarily make one the victim of a fraud. As common law principles dictate, the victim, *viz.*, the proper plaintiff, is the one who was induced by the wrongdoer to rely upon the misrepresentation.

Respondents' purported injury was not directly induced by the alleged fraud. Rather it was derivative of the alleged fraud that was allegedly perpetrated against the county. This is made plain by the fact that, assuming the allegations proved true, petitioners would have been subject to criminal liability for their acts against the county, not any act against respondents. *See* 18 U.S.C. § 1341; *Neder*, 527 U.S. at 25.[12]

b. Finally, if this Court were to conclude that respondents' injuries were not derivative of some injury of the county and thus were recoverable under 18 U.S.C. § 1964(c), even in the absence of their own reliance, the Court should limit the circumstances where a civil RICO plaintiff can recover in the absence of his own justifiable reliance on a misrepresentation by the defendant.

The Court should not adopt the court of appeals' "principal losers" approach, but should, at a

[12] For that reason, the reasoning of the court below, that the county could not be "the victim of the[] fraud" because the county "did not lose even a penny," Pet. App. 5a, is irrelevant. Under the Seventh Circuit's reasoning, if the county lost a penny, respondents' injury would have been derivative.

minimum, hold that a plaintiff does not satisfy the reliance requirement merely because it suffered the most economic harm. *Holmes*, 503 U.S. at 268; *Anza*, 126 S. Ct. at 1996. Only the "immediate victim" should be permitted to recover, and a plaintiff should not be considered an immediate victim unless no other class of individuals closer to the alleged misrepresentation is legally capable (as opposed to factually capable) of suffering an injury due to the misrepresentation.[13] That plaintiff should be required to demonstrate both that the third party's reliance on the misrepresentation was justifiable and that the plaintiff's reliance on the third party was likewise justifiable. While such an approach would depart from the common law principles of fraud, it would, at least, limit recovery to circumstances where no other party can claim a more direct injury due to the purported fraud.[14]

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[13] If a third party could have been injured but escaped injury, a derivatively harmed plaintiff should not be able to recover as the "immediate victim."

[14] For example, if the county charged $1000 per bid and fewer companies signed up due to the alleged misrepresentation by petitioners, the county would be the immediate victim of the fraud and would lose some revenue, but it would not necessarily be the principal loser. In such circumstances, respondents still may have suffered greater losses, but their injury would be derivative of the county's.

CONCLUSION

For the reasons set forth above and in petitioners' brief, the judgment of the court of appeals should be reversed.

Respectfully submitted,

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