THE SUPREME COURT APPLIES THE DIRECT RELATIONSHIP STANDARD FOR THE PURPOSE OF PROXIMATE CAUSE IN CIVIL RICO CLAIMS

Aquilio, Mark
St. John's University

ABSTRACT
In Hemi Group, LLC and Kai Gachupin v. City of New York, 130 S. Ct. 983 (2010) the Supreme Court recently ruled that New York City lacked standing to bring a civil RICO claim to collect cigarette taxes on internet sales made by out-of-state sellers who failed to file reports with New York State as required by the Jenkins Act. The Court held there was not standing to bring a civil claim under RICO § 1964(c) by asserting a violation of RICO § 1962(c) via mail and wire fraud, as there was not proximate cause. The Court reasoned that there was not a direct relationship between New York City's loss of tax revenue and the failure of the sellers to file the reports. Rather, it was the failure of the purchasers of the cigarettes to pay the tax that caused the direct harm to New York City. The failure to file the Jenkins Act reports caused harm to New York State rather than New York City. The conduct directly causing the lost tax revenue (the failure to pay the tax) was distinct from the fraudulent conduct of not filing the Jenkins Act reports. Thus, the civil RICO claim not only rested on separate actions but also separate actions carried out by separate parties. The Court also rejected New York City's position that the civil RICO claim was supported by a systematic scheme to thwart tax collection.

INTRODUCTION
The difficult economic times which have befallen our country have adversely impacted the revenues collected by state and local governments. One area where governments have sought to increase revenues is through increased taxes on the sale of cigarettes and efforts to collect those taxes. This has caused an increase in efforts by vendors and purchasers of cigarettes to avoid the payment of cigarette taxes. It has also caused headlines for years regarding the battle between New York State and Native Americans selling cigarettes on reservations in upstate New York over the collection of cigarette taxes. In fact, in a news release from the Bureau of Alcohol, Tobacco, Firearms and Explosives titled "Cigarette Smuggling – States Lose Millions in Tax Revenue" issued March 18, 2008 the ATF estimates that billions of dollars per year of cigarette taxes are evaded through various means.

One area of tax evasion involved out-of-state vendors selling cigarettes over the internet to residents of New York City. While the vendors were not required to charge, collect, or remit the taxes imposed by New York City (NYC) on the possession of cigarettes, the purchasers were required to pay the tax but seldom did. Also, while the vendors were required to file reports with New York State regarding the sales, pursuant to the Jenkins Act, they failed to do so. Interestingly, NYC sought to collect the tax from the vendors employing the civil remedies provisions of the Racketeer Influenced and Corrupt Organizations Act (RICO). Ultimately, the Supreme Court ruled in *Hemi Group, LLC and Kai Gachupin v. City of New York,* 130 S. Ct. 983 (2010) that NYC lacked standing to bring a civil RICO claim.

Addressing the concern that organized crime was expanding beyond its traditional sources of revenue from illegal activities into what appeared to be legitimate businesses, Congress enacted RICO as title IX of the Organized Crime Control Act, Pub. L. 91-542, 84 Stat. 941, as amended, 18 U.S.C. §§ 1961-1968

(2000 ed. and Supp. III). Congress was aware that RICO would have the potential to sweep more broadly than organized crime, and the courts have interpreted RICO accordingly.

Besides criminal penalties, Congress included civil remedies in RICO § 1964 (c). Its intention was to compensate the victims of organized crime and aid law enforcement efforts by in effect deputizing civil litigants as "private attorneys general." The civil remedies provision provides for treble damages and attorneys' fees, thus empowering and encouraging the victims of RICO criminal violations to detect, stop, and discourage such activities by bringing civil RICO claims.

It is now commonplace to see in the headlines the government pursuing RICO criminal prosecutions against not only the elements of organized crime but also of business executives. Of equal importance is the development of the law with regard to civil RICO claims, particularly the proximate cause necessary to bring a civil RICO claim. In fact, it is of such importance that in 1992, the Supreme Court addressed the issue in *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258; 112 S. Ct. 1311; 117 L. Ed. 2d 532 (1992) and revisited the issue three times in the last five years in *Anza, et al, v. Ideal Steel Supply Corp.,* 547 U.S. 451; 126 S. Ct. 1991; 164 L. Ed. 2d 720 (2006); *Bridge, et al. v. Phoenix Bond & Indemnity Co. et al,* 553 U.S. 639; 128 S. Ct. 2131; 170 L. Ed. 2d 1012 (2008); and *Hemi Group, supra.*

Most recently, in *Hemi Group,* the Supreme Court reversed the Second Circuit Court of Appeals' ruling in *City of New York v. Nexicon, Inc., Hemi Group, LLC., et al.*, 541 F.3d 425 (CA-2, 2008), which consolidated four cases and reversed the decisions of the District Court of the Southern District of New York. Hemi Group, LLC et al. were parties in the case brought against Nexicon, Inc., which was formerly known as CYCO.net, Inc. The Second Circuit held in a 2-1 decision that NYC has standing to bring a civil RICO claim to collect cigarette taxes on internet sales made by out-of-state sellers who failed to file reports with New York State as required by the Jenkins Act. The court held there was standing to bring a civil claim under RICO § 1964(c) by asserting a violation of RICO § 1962(c) via wire and mail fraud, which caused damages to its "business or property," even though they did not arise from a commercial transaction. Also, the court opined that there were distinct RICO "persons" and "enterprises" and the proximate cause necessary to bring a civil RICO claim. However, applying the direct relationship standard for proximate cause, the Supreme Court ruled that NYC lacked standing to bring the civil RICO claim.

In 2005 the District Court dismissed NYC's state law claims and it's RICO claims, with leave to amend, for failure to plead "distinctness" in the enterprise allegations necessary for RICO in *City of New York v. CYCO.net, Inc. et al.*, 383 F. Supp. 2d (S.D.N.Y., 2005). While the state law claims are not discussed herein, they were eventually all denied. In 2006, after the City amended its complaints, the District Court again dismissed the complaints, this time with prejudice, for failure to plead the "distinctness" in the enterprise element necessary in *City of New York v. Nexicon, Inc. f/k/a CYCO.net, Inc. et al.*, No. 03 Civ. 383, 2006 U.S. Dist. LEXIS 10295 (S.D.N.Y. Mar. 15, 2006); *City of New York v. Smokes-Spirits.com, Inc. et al.,* No. 04 Civ. 6616, 2006 U.S. Dist. LEXIS 11954 (S.D.N.Y. Mar. 21, 2006); *City of New York v. NCCigarettes*, No. 03 Civ. 7715, 2006 U.S. Dist. LEXIS 11922 (S.D.N.Y. Mar. 22, 2006); and *City of New York v. EZTobacco, No.* 03 Civ. 10091, 2006 U.S. Dist. LEXIS 11953 (S.D.N.Y. Mar. 22, 2006). As in 2005, the District Court dismissed the *Nexicon (*f/k/a *CYCO.net, Inc.)* case first. It then dismissed the other three related cases on collateral estoppel grounds.

The effects of *Hemi Group* are far-reaching and further clarify the direct injury standard applicable to establish the proximate cause necessary to have standing to bring a civil RICO claim, thus impacting the broadness of the reach of the civil RICO provision resulting in treble damages and attorneys' fees. Prior to an analysis of *Hemi* Group, a brief overview of the relevant provisions of RICO and the proximate cause required to bring a civil RICO claim is in order.

OVERVIEW OF THE PROVISIONS OF RICO RELEVANT TO THE HOLDING IN HEMI GROUP

The civil remedies provision of RICO provides in relevant part that "[a]ny person injured in his business or property *by reason of* a violation of section 1962 of this chapter [Title 18] may sue therefore in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee." 18 U.S.C. § 1964(c) (emphasis added).

Section 1962 provides, in relevant part:

> (c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity... .

Thus, to establish standing and state a claim for civil damages under RICO, a plaintiff must allege that: (1) the defendant has violated a substantive provision of RICO § 1962; (2) an injury to the plaintiff's business or property; and (3) that the injury was caused *by reason of* the defendant's violation of RICO § 1962.

To plead a violation of the substantive RICO statute, a plaintiff must allege the existence of seven constituent elements: "(1) that the defendant (2) through the commission of two or more acts (3) constituting a 'pattern' (4) of 'racketeering activity' (5) directly or indirectly invests in, or maintains an interest in, or participates in (6) an 'enterprise' (7) the activities of which affect interstate or foreign commerce." *Moss v. Morgan Stanley Inc*., 719 F.2d 5 (CA-2, 1983), *cert. denied*, 465 U.S. 1025 (1984).

Racketeering activity "consists of no more and no less than the commission of a predicate act." *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 496 (1985). A "pattern of racketeering activity" is defined as requiring the commission of at least two of the predicate acts enumerated in RICO § 1961(1) within a ten year period per RICO § 1961(5). RICO § 1961(1)(B) defines "racketeering activity" as any act that is indictable under, inter alia, 18 U.S.C. §§ 1341 (prohibiting mail fraud), and 1343 (prohibiting wire fraud). 18 U.S.C. §§ 1341 and 1343 prohibit the use of the mail or wire communication to further "any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises." As the Court stated in *Bridge*, "The gravamen of the offense is the scheme to defraud, and any 'mailing that is incident to an essential part of the scheme satisfies the mailing element,' even if the mailing itself 'contain[s] no false information,'...." *Bridge*, 553 U.S. at 647. Furthermore, "To constitute a violation . . . it is not necessary to show that [defendants] actually mailed . . . anything themselves; it is sufficient if they caused it to be done." *Pereira v. United States*, 347 U.S. 1, 8, 74 S. Ct. 358, 98 L. Ed. 435 (1954).

Regarding the "enterprise" requirement, the Supreme Court has reasoned that a plaintiff must "allege and prove the existence of two distinct entities: (1) a 'person'; and (2) an 'enterprise' that is not simply the same 'person' referred to by a different name." *Cedric Kushner Promotions, Ltd. v. King*, 533 U.S. 158, 161-62, 121 S. Ct. 2087, 150 L. Ed. 2d 198 (2001). A "person" is defined in RICO § 1961(3) as "any individual or entity capable of holding a legal or beneficial interest in property." RICO § 1961(4) defines an "enterprise" as "any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity."

A RICO enterprise based on an association-in-fact theory is "a group of persons associated together for a common purpose of engaging in a course of conduct," the existence of which is "proved by evidence of an ongoing organization, formal or informal, and by evidence that the various associates function as a continuing unit." *United States v. Turkette*, 452 U.S. 576, 583, 101 S. Ct. 2524, 69 L. Ed. 2d 246 (1981).

The dual requirements of distinctness and the evidence needed to establish an association-in-fact serve to eliminate claims brought as RICO actions but which are not. The "distinctness doctrine" requires a plaintiff to demonstrate that the RICO "person" is legally separate from the RICO "enterprise." The association-in-fact requirements prevent distinctness from being established by simply tacking on entities to the "enterprise" which do not function as a "continuing unit" or share a "common purpose." *See*, *Turkette,* 452 U.S. at 583.

Plaintiffs often attempt to bring their civil claim under RICO § 1964 (c) in order to recover the treble damages and attorneys' fees awarded therein. Aware of this "jackpot mentality," the judiciary is often confronted with standing challenges to civil RICO claims. In *Katzman v. Victoria's Secret Catalogue*, 167 F.R.D. 649, 655 (S.D.N.Y., 1996) (citations omitted), *aff'd*, 113 F.3d 1229 (CA-2, 1997) the court stated "Civil RICO is an unusually potent weapon – the litigation equivalent of a thermonuclear device. Because the mere assertion of a RICO claim ... has almost inevitable stigmatizing effect on those named as defendants ... courts should strive to flush out frivolous RICO allegations at an early stage of the litigation." Accordingly, the courts scrutinize closely challenges to a plaintiff's standing to bring a civil RICO claim, particularly with regard to the required proximate cause element.

In order to satisfy the requirement in RICO § 1964 (c) that a plaintiff demonstrate its business or property was injured *by reason of* the defendant's violation of RICO § 1962, the plaintiff must show proximate cause. In *Holmes,* evaluating proximate cause for RICO purposes, the Court looked to its common law foundations and established that in the context of a civil RICO claim, the plaintiff must establish that the RICO violation was not only the "but for" cause of the damages but was also the legally cognizable or "proximate cause" of the damages. Noting that the concepts of direct relationship and foreseeability are two of the "many shapes [proximate cause] took at common law," the *Holmes* court applied the direct relationship standard, which was subsequently followed in *Anza, Bridge,* and *Hemi Group.* Accordingly, in *Holmes, Anza, Bridge,* and *Hemi Group*, the Supreme Court has consistently applied the standard that proximate cause requires a direct relation between the RICO violation and the injury suffered.

In *Holmes,* Securities Investor Protection Corporation (SIPC), a private corporation with a duty to reimburse the customers of registered broker-dealers who became unable to meet their financial obligations, alleged that Robert Holmes conspired with others to manipulate stock prices. The fraud resulted in a precipitous stock price drop, causing two broker-dealers financial difficulties resulting in their liquidation and inability to meet their obligations to their customers. Hence, SIPC had to advance nearly $13 million to cover the claims of customers of those broker-dealers. SIPC sued Holmes on the theory, among others, that he violated RICO §1962(c). SIPC claimed that it was subrogated to the rights of those customers of the broker-dealers who did not purchase manipulated securities. The Court ruled against SIPC reasoning that the nonpurchasing customers' injury was not proximately caused by the defendant's conduct, because "the conspirators have allegedly injured these customers only insofar as the stock manipulation first injured the broker-dealers and left them without the wherewithal to pay customers' claims." *Holmes*, 503 U.S. at 271.

While *Holmes* required "some direct relation between the injury asserted and the injurious conduct alleged," it further held that a connection that is "too remote," "purely contingent," or "indirec[t]" does not establish proximate cause. *Holmes*, 503 U.S. at 271 and 274. Accordingly, *Holmes* rejected an interpretation of the *"by reason of"* language to require only that the RICO violation was a "but for" cause of the plaintiff's injury. It noted the "unlikelihood that Congress meant to allow all factually injured plaintiffs to recover." *Holmes*, 503 U.S. at 266. The Court explained that proximate cause is a flexible concept not lending itself to "a black-letter rule that will dictate the result in every case." It noted that the direct-relation requirement for proximate cause eliminates the difficulties attended to determining the plaintiff's damages due to the defendant's actions as opposed to other independent factors. It also

prevents courts from having "to adopt complicated rules of apportioning damages among plaintiffs removed at different levels of injury from the violative acts, to obviate the risk of multiple recoveries," and acknowledges that "directly injured victims can generally be counted on to vindicate the law as private attorneys general, without any of the problems attendant upon suits by plaintiffs injured more remotely." *Holmes*, 503 U.S. at 269-70.

Ultimately, the Court found the connection between the alleged stock manipulation and the broker-dealers' customers' losses as too remote since it was purely contingent on the harm suffered by the broker-dealers. It held that SIPC's losses were not directly related to the defendant's injurious activity, but were derivatively associated.

In *Holmes,* the Court reiterated that "[t]he general tendency of the law, in regard to damages at least, is not to go beyond the first step." *Holmes,* 503 U.S. at 271-272, (quoting *Associated Gen. Contractors of Cal., Inc. v. Carpenters,* 459 U.S. 519, 534, 103 S. Ct. 897, 74 L. Ed. 2d 723 (1983), in turn quoting *Southern Pacific Co. v. Darnell-Taenzer Lumber Co.,* 245 U.S. 531, 533, 38 S. Ct. 186, 62 L. Ed. 451 (1918), internal quotation marks omitted). Since *Holmes,* the Supreme Court has confirmed that this rule applies with "full force" to RICO civil claim proximate cause determinations in *Anza, Bridge,* and *Hemi Group.* Also, in *Holmes* the Court established that one consideration relevant to the RICO "direct relationship" requirement to establish proximate cause is whether better situated plaintiffs would have an incentive to sue under RICO. *See, Holmes*, 503 U.S. at 269-270.

In recent years the scope of RICO civil claims was expanding in the area of unfair competition. However, in *Anza,* the Supreme Court severely limited civil RICO claims by ruling that Ideal lacked standing to bring a civil claim under RICO § 1964(c) based on RICO § 1962(c) seeking recovery of damages to its business caused by its competitor's alleged racketeering activity of unlawfully selling products free of state and local sales tax and submitting fraudulent sales tax returns in violation of mail and wire fraud statutes. The tax scheme allegedly cost Ideal profits as it lost customers to its competitors who weren't charging the sales tax. The Court ruled that Ideal could not maintain its RICO claim as proximate cause was lacking. The Court reasoned that there was not a *direct relation* between the asserted injury and the alleged injurious conduct. It viewed NYS as the direct victim of the RICO violations rather than Ideal. Applying *Holmes,* the Court opined that National's decreased prices for cash-paying customers could have been due to any number of reasons unrelated to the mail and wire fraud and also that Ideal's lost revenues could have been caused by other factors. The Court viewed the speculative nature of Ideal's claim as further evidence that its injury was not the direct result of the RICO violations, stating, "[a] court considering the claim would need to begin by calculating the portion of National's price drop attributable to the alleged pattern of racketeering activity. It next would have to calculate the portion of Ideal's lost sales attributable to the relevant part of the price drop. The element of proximate causation recognized in *Holmes* is meant to prevent these types of intricate, uncertain inquiries from overrunning RICO litigation. It has particular resonance when applied to claims brought by economic competitors, which, if left unchecked, could blur the line between RICO and the antitrust laws." *Anza,* 547 U.S. at 459-60.

Since it ruled that the claim lacked proximate cause as Ideal was not the *immediately direct victim* of the alleged racketeering activity (New York State was), the Court did not rule on whether reliance on the fraudulent misrepresentations by Ideal was a necessary element to the civil RICO claim or proximate cause.

In *Bridge,* the Supreme Court applied the direct injury standard of proximate cause and unanimously ruled that a plaintiff asserting a civil RICO claim predicated on mail fraud need not show, either as an element of its claim or as a prerequisite to establishing proximate cause, that it relied on the defendant's alleged misrepresentations. The Court held that Phoenix Bond & Indemnity Co. had standing to bring a

civil RICO claim based on mail fraud which caused damages to its business due to its competitor unlawfully acquiring tax liens from Cook County, Illinois that it could have acquired and profited from when it sold the properties subject to the tax liens.

In *Bridge,* annually the Treasurer's Office of Cook County, Illinois conducts a public auction where it sells tax liens on the property of delinquent taxpayers. Rather than bidding in cash amounts the bids are made as percentage penalties which the property owner must pay the winning bidder (buyer) to clear the tax lien. The lowest penalty percentage bid wins the auction. The buyer pays off the delinquent taxes and receives the tax lien. The property owner still has the right to redeem the property within the statutorily mandated redemption period by paying the buyer the delinquent taxes, any taxes paid by the buyer accruing after the purchase of the tax lien plus a 12% penalty on those taxes, and the percentage penalty bid at the auction. If the owner doesn't redeem the property, the buyer may obtain a tax deed for the property and essentially purchase the property for the taxes paid.

Since most bidders intend to make a profit by reselling the property above the amount paid to the County in back taxes to acquire the tax lien rather than from the penalty assessed on any redeeming property owner, most parcels attract multiple bids at the lowest percentage bid allowable under County regulation of 0%. Negative bids conceivably are not allowed as that would give taxpayers incentive not to pay their taxes and then redeem the property by paying the delinquent taxes less the penalty amount.

When the bidding ends in a tie, *e.g*., multiple bids at 0%, the County allocates parcels "on a rotational basis" in order to ensure that the liens are apportioned fairly among 0% bidders. As the Seventh Circuit stated, "If X bids 0% on ten parcels, and each parcel attracts five bids at that penalty rate, then the County awards X two of the ten parcels. Winners share according to the ratio of their bids to other identical bids. This creates an incentive to submit multiple bids per parcel, either directly or through agents. If Y submits two bids per parcel, then its take from the auction will be double that of X. To prevent this, the County promulgated what it calls the 'Single, Simultaneous Bidder Rule' (Rule)." *Phoenix Bond & Indemnity Co.*, 477 F.3d at 929. The Rule provides that "one tax buying entity (principal) may not have its/his/her/their actual or apparent agents, employees, or related entities, directly or indirectly register under multiple registrations for the intended or perceived purpose of having more than one person bidding at the tax sale at the same time for the intended or perceived purpose of increasing the principal's likelihood of obtaining a successful bid on a parcel." When registering for the annual auction, every potential bidder must furnish the County with a sworn affidavit that no agent or other related entity will participate in that auction and it complies with the Rule.

Bridge et al. broke the Rule and fraudulently acquired a disproportionate share of the liens. Applying the direct injury standard, the Court reasoned that the damages caused by the loss of the tax liens directly resulted from the fraudulent misrepresentations. It ruled that there were no independent factors accounting for the injury, there was no risk of duplicative recoveries by any other plaintiffs removed at different levels of injury by the violation, and no more immediate victim better suited to bring the civil RICO claim than Phoenix Bond & Indemnity Co., et al. In fact, the Court opined that any damages Cook County would suffer if the taint of fraud deterred future bidders from participating in the auction was speculative and remote as opposed to the direct financial injury incurred by the losing bidders which were injured by the RICO violations.

OVERVIEW OF THE PROVISIONS OF THE JENKINS ACT RELEVANT TO THE HOLDING IN HEMI GROUP

In 1949 Congress enacted the Jenkins Act (15 U.S.C. §§ 375-378) to offset the loss of state taxes caused by interstate taxing discrepancies. It requires out-of-state cigarette sellers to file a report with the tobacco tax administrator of each state into which the seller ships cigarettes to non-distributors, identifying the

name, address, and quantity of cigarettes purchased by the non-distributor state residents. An amendment to the Jenkins Act in 1955 requires the seller of cigarettes in interstate commerce to register with the tobacco tax officials of states where he advertises or into which he ships cigarettes. *See*, 15 U.S.C. § 376(a). States use the information provided by out-of-state cigarette sellers under the Jenkins Act to collect the payment of cigarette taxes directly from the purchasers.

As amended, at the time of *Hemi Group,* the Jenkins Act provided:

> "Any person who sells or transfers for profit cigarettes in interstate commerce, whereby such cigarettes are shipped into a State taxing the sale or use of cigarettes, to other than a distributor licensed by or located in such State, or who advertises or offers cigarettes for such a sale or transfer and shipment, shall--
>
> (1) first file with the tobacco tax administrator of the State into which such shipment is made or in which such advertisement or offer is disseminated a statement setting forth his name and trade name (if any), and the address of his principal place of business and of any other place of business; and
>
> (2) not later than the 10th day of each calendar month, file with the tobacco tax administrator of the State into which such shipment is made, a memorandum or a copy of the invoice covering each and every shipment of cigarettes made during the previous calendar month into such State; the memorandum or invoice in each case to include the name and address of the person to whom the shipment was made, the brand, and the quantity thereof." *See*, 15 U.S.C. § 376(a).

HEMI GROUP AND KAI GACHUPIN V. CITY OF NEW YORK

The facts in *Hemi Group* are complex. As most states do, New York State (NYS) imposed a tax on all cigarettes used or sold in NYS ($2.75 per pack at the time of *Hemi Group*). It also authorized NYC to impose its own tax on cigarettes; thus, NYC imposed a tax on all cigarettes possessed in NYC for sale or use ($1.50 per pack). Generally, the combined NYS and NYC cigarette taxes are either the highest or among the highest in the nation. When purchasers buy cigarettes from in-state vendors, it is the responsibility of the seller to charge, collect, and remit the tax. At the time of *Hemi Group,* however, out-of-state cigarette sellers were not responsible for collecting or paying either the NYS or the NYC sales taxes on cigarettes. Rather, NYC was responsible to collect use taxes on cigarettes sold outside NYC directly from the customers. Additionally, consistent with the Commerce Clause, NYC could not compel an out-of-state seller to collect a city sales tax. *See, Quill Corp. v. North Dakota,* 504 U.S. 298 (1992) and *National Bellas Hess, Inc., v. Dept. of Revenue of Ill.,* 386 U.S. 753 (1967).

The Jenkins Act requires out-of-state cigarette sellers to report only to state tobacco tax administrators. However, NYS and NYC had entered into various agreements for the administration and collection of cigarette taxes whereby NYC alleged it was to be “fully and promptly” informed by the NYS Department of Taxation and Finance of any information relevant to the collection of cigarette taxes, including Jenkins Act reports. Specifically, NYS and NYC executed an agreement whereby they both undertook to "cooperate fully with each other and keep each other fully and promptly informed with reference to any person or transaction subject to both State and City cigarette taxes including [i]nformation obtained which may result in additional cigarette tax revenue to the State or City provided that the disclosure of that information is permissible under existing laws and agreements."

Hemi Group, a New Mexico company, sold cigarettes online to NYC residents. Orders were then shipped by common carrier or the United States Postal Service into NYC; however, Hemi Group did not comply

with the Jenkins Act registration or reporting requirements. NYC contended that the savings due to purchasing the cigarettes online were almost entirely generated by the failure to charge or pay the NYS and NYC taxes; thus, the failure to comply with the Jenkins Act was an essential part of Hemi Group's business model. While Hemi Group was not liable to charge, collect, remit, or pay the tax, it failed to notify customers of their use tax obligations. Also, it made false representations to customers, such as informing inquiring customers that it is prohibited from disseminating customer information to taxing authorities, advertising their cigarettes as "tax-free," and assuring customers that sales would not be reported to the NYS tax authorities. NYC contended that these actions were part of a general "systematic scheme to defraud the City of tax revenue." Accordingly, NYC alleged that Hemi Group engaged in a "pattern of racketeering" prohibited by RICO § 1962(c) by committing mail or wire fraud each time it used, or caused to be used, the mails or wires to effect a sale of cigarettes to a NYC resident and failed to comply with the Jenkins Act's reporting requirements to NYS, thus causing NYC injury to "business or property" under RICO § 1964(c) in the amount of "tens if not hundreds of millions of dollars a year in cigarette excise tax revenue."

As previously noted, the Second Circuit reversed the District Court and ruled that NYC has standing to bring a civil RICO claim. In dismissing NYC's RICO claims, the District Court ruled that while the structure of Hemi Group was legally viable, Hemi owner and officer Kai Gachupin did not have an individual duty to file Jenkins Act reports, and thus could not have committed the alleged predicate racketeering acts. Therefore, it held that NYC could not establish that Hemi Group and Gachupin formed an "enterprise" which is required to establish RICO liability. Accordingly, the District Court did not opine on whether NYC's injury was caused "by reason of" Hemi Group's failure to file Jenkins Act reports or whether NYC's loss of tax revenue constitutes an injury to its "business or property" under RICO § 1964.

In reversing the District Court, the Second Circuit ruled that NYC adequately (1) established a violation of RICO § 1962(c) as Hemi Group and Gachupin operated as an "enterprise" and that the enterprise committed the predicate RICO violations of mail and wire fraud due to the failure to report to NYS in accordance with the Jenkins Act, (2) demonstrated injury to its "business or property" and (3) the injury was "by reason of" the alleged RICO violations as required by RICO § 1964(c), thus satisfying the proximate cause standard. The court analyzed each of these issues in reverse order.

Regarding the issue of proximate cause, the court applied the standards established in *Anza*, *Holmes* and *Sedima*. The court held that the injury suffered by NYC, a specific dollar amount of taxes imposed on each pack of cigarettes sold without filing the necessary Jenkins report, was a direct result of the fraudulent scheme to deny NYC use taxes, which was the central theme of the alleged predicate acts of mail and wire fraud. The court stated, "The City's claims are easily distinguishable from the ones found to be insufficient in *Holmes.* … That New York State may also have been injured by defendants' alleged schemes does not make the City's injury any less direct; the City is owed a certain amount of taxes independent of any amount owed to or collected by the State. … The fact that the failure to file Jenkins Act reports with the State leads directly to the City's alleged harm, namely loss of tax revenues, also distinguishes this case from *Anza,* where the injury was found to be too attenuated. … Moreover, *Anza* is distinguishable from this case in two important, related, respects. First, *Anza* involved a RICO claim of a competitor complaining of another merchant's ability to offer lower prices, and the Court's holding sought to limit RICO standing in that type of case. ... As the Court explained, 'claims brought by economic competitors . . . if left unchecked, could blur the line between RICO and the antitrust laws.' ... Second, because competition claims may involve a host of market factors unrelated to the alleged RICO violation, following the causal chain and measuring damages involve evidentiary complexities beyond what a factfinder should be expected to reasonably or reliably parse through. … Here, by contrast, the City's

claim is not market based. While the City's case will not be free of evidentiary wrinkles, any potential wrinkles are nowhere near the type or degree involved in *Anza*. " *Nexicon, Inc.,* 541 F.3d at 441-442.

The court reasoned that the *Holmes* standard is satisfied as the direct damages could easily be calculated by counting the packs of cigarettes sold by the defendants. Also, the court held that the fact that the cigarette purchasers might be partially to blame for the injury doesn't defeat proximate cause as the Second Circuit has held that defendants are still liable where their actions were a substantial factor in causing the loss in *Lerner v. Fleet Bank, N.A.,* 459 F.3d 273 (CA-2, 2006). The court stated, "A contrary rule would effectively require that a plaintiff's injury be caused by only one source, and, as this is often not the case, it would operate to insulate from liability defendants who scheme with others in violation of RICO. Here, defendants' actions are clearly alleged to be a substantial factor in the City's loss." *Nexicon, Inc.,* 541 F.3d at 443.

The court reasoned that the concern in *Holmes* of apportioning damages among plaintiffs so that there aren't multiple recoveries is not a problem as only NYC can claim loss of its use taxes and NYS would have separate damages since it charges separate taxes. Also, it determined that while NYS may also seek to sue to vindicate the law, NYC should not have to rely on NYS to sue under RICO, where its injury of lost taxes is no less direct than the injury of NYS.

In dealing with the Second Circuit cases cited by the defendants to support their claim where causation was lacking, the court stated, "… there are no speculative steps in this chain of causation. When defendants fail to comply with the Jenkins Act, defendants deprive both the City and the State of information needed to collect taxes from the in-State and in-City cigarette purchasers. And the City has alleged that it 'will be 'fully and promptly' informed by the New York State Department of Taxation and Finance of any information relevant to the collection of cigarette taxes, including Jenkins Act reports.' … Though the City and State are injured by the same activity, the City's injury does not depend on the State being injured. … And it is clear that the City is alleged to be the target of the scheme because a large part of, if not the driving force behind, defendants' business plans was to sell cigarettes in such a way as to allow consumers to evade New York City's taxes. …The fact that the State may also have been targeted by defendants' schemes does not change the result. … 'No precedent suggests that a racketeering enterprise may have only one 'target,' or that only a primary target has standing'; indeed, 'there is a broad class of plaintiffs under RICO.'…". *Nexicon, Inc.,* 541 F.3d at 443-444.

Interestingly, the court opined that the predicate racketeering acts were the mail and wire fraud violations and not the Jenkins Act violations. Thus, causation is determined by viewing the mail and wire fraud and tying it directly to the lost taxes. The court stated, "In the City's allegations, the Jenkins Act violations form the basis of defendants' *scheme to defraud*, an essential element of the alleged predicate acts of mail and wire fraud, which targeted both the City and State in an effort to deprive both of the information needed to collect use taxes. The fact that defendants have no statutory duty to the City under the Jenkins Act does not make the City's alleged harm from the mail and wire fraud violations derivative, unforeseeable, or any less direct. … [T]he mail and wire fraud statutes extend to protect taxing authorities from fraud. … Moreover, we do not share our dissenting colleague's concern that this case represents a 'major expansion of mail fraud doctrine.' … [T]he City has alleged an injury in the form of lost taxes that is independent from, even if parallel to, any injury suffered by the State. … By recognizing the City's right to proceed in this case, we are neither extending the scope of the mail and wire fraud statutes, nor the scope of RICO, beyond their established reach." *Nexicon, Inc.,* 541 F.3d at 444.

Regarding the issue that NYC demonstrated injury to its "business or property," the court ruled that the injury was not required to be one incurred by NYC as a party to a commercial transaction. Thus, lost taxes constitute injury to "business or property" under RICO. The court ruled that its holding in *Town of*

West Hartford v. Operation Rescue, 915 F.2d 92(CA-2, 1990), where it suggested that a municipality must have sustained its injury as a party to a commercial transaction to have standing under RICO, was dicta, citing *Att'y Gen. of Can. v. R.J. Reynolds Tobacco Holdings, Inc.*, 268 F.3d 103, 132 n.40 (CA-2, 2001), *cert. denied*, 537 U.S. 1000 (2002). The court reasoned that the Supreme Court has held RICO is to be read broadly, and that there is no reason to add another standing requirement on municipalities for civil RICO claims. It noted that the Second Circuit has ruled that tax losses due to unpaid taxes are "property" under the mail and wire fraud statutes. In addition, the court viewed *Anza* as suggesting that the Supreme Court implied a State would have a recoverable injury based on lost taxes due to fraud.

The Second Circuit's decision adds to the split among the circuit courts over whether the injury to "business or property" requires that a governmental entity be acting in its sovereign capacity to have standing. The Seventh Circuit in *Illinois Dep't of Revenue v. Phillips,* 771 F.2d 312 (CA-7, 1985) rejected the requirement that a State government unit must be alleging competitive or commercial injuries under RICO. In reversing the district court the court stated, "Although we have doubts about the application of RICO to the facts of this case we cannot say that it does not come within the framework of the statute." *Nexicon, Inc.,* 541 F.3d*,* at 317.

Conversely, the Ninth Circuit in *Canyon County v. Syngenta Seeds, Inc.,* 519 F.3d 969, 979 (CA-9, 2008), *cert. denied*, 129 S.Ct. 458 (2008) held that a county government lacked RICO standing to sue for injuries it alleged incurred "in its sovereign and/or quasi-sovereign capacities… ." It relied on *Hawaii v. Standard Oil Co.,* 405 U.S. 251, 264 (1972) where the Supreme Court held that Hawaii lacked standing under the Clayton Act because the phrase "business or property" refers "to commercial interests or enterprises," and does not include loss of tax revenues.

The Sixth Circuit also held that a State government and its subdivisions lack standing under RICO to sue for damages from noncommercial losses as "injury to business or property" when it affirmed the district court's decision in *Michigan Dep't of Treasury v. Fawaz*, 653 F. Supp. 141 (E.D. Mich., 1986), *aff'd*, 848 F.2d 194 (CA-6, 1988) holding that Michigan could not use RICO to sue its own citizens in a federal forum for state sales tax violations. The Sixth Circuit affirmed the district court in a decision not recommended for full text publication. *See also*, *Township of Marlboro v. Scannapieco*, 545 F. Supp. 2d 452 (D. N.J., 2008) (seeking damages due to bribes to Township employees) and *West Virginia v. Moore*, 895 F. Supp. 864 (S.D. W.Va. 1995) (seeking the recovery of lost tax revenue), where district courts in the Third and Fourth Circuits, respectively, denied standing in RICO claims by governmental authorities.

Regarding its holding that NYC adequately pleaded a violation of RICO § 1962 (c), the court stated that it is settled law in the Second Circuit that a Jenkins Act violation may form the basis of a mail and wire fraud conviction. It held that the named RICO defendants directed the enterprises not to file Jenkins Act reports while using the mails or wires to affect the sales to NYC residents, which constitutes a scheme to defraud NYC of use taxes as the defendants deprived it of the information needed to collect those taxes. In addition, the court held that NYC generally adequately alleged the existence of two distinct entities, namely a "person" and "enterprise" that is not the same "person." The court applied the distinctiveness standard to each of the enterprises in the case and found the standard generally satisfied.

In a well-reasoned dissent, Judge Winter opined that the RICO violations were not the proximate cause of NYC's injuries, thus it lacked standing under RICO. Winter reasoned that the alleged fraud is based on violations of the Jenkins Act, thus the nature and consequences of the fraud should be determined by the scope of it. Winter rejected the majority's opinion that the predicate racketeering acts were not Jenkins Act violations, but were the mail and wire fraud violations. He noted the majority's description of the allegations of mail and wire fraud, its direct cause of the injury, and the calculation of damages was tied to the failure to comply with the Jenkins Act. Hence, he reasoned, the only fraudulent acts that "sound of

fraud" are violations of the Jenkins Act. He also noted that there are no cases holding an illegal failure to report sales to a state tax authority constitutes fraud on a municipal tax authority.

He stated, "Absent the Jenkins Act, appellees would have owed no duty to disclose their sales to anyone, and their failure to disclose could not conceivably be deemed fraud of any kind. Appellees owe no taxes to the City. The tax evasion is by the purchasers of the tobacco products. Even with the Jenkins Act, which requires reporting only to state authorities, appellees have no duty to disclose anything to the City. Indeed, conspicuously absent from the City's pleadings is any claim brought pursuant to the Jenkins Act itself, rather than RICO, seeking enforcement of the Jenkins Act, effectively an admission that the Act does not protect the City. *Nexicon, Inc.,* 541 F.3d at 460.

Winters disagreed with the majority's distinguishing of *Anza*. He stated, "First, they emphasize that the plaintiff in *Anza* was a competitor of the defendant. If anything, however, the plaintiff in *Anza* had a stronger case with respect to proximate causation than the plaintiff here. In *Anza*, the defendant was the tax evader and had thereby lowered its costs and gained a competitive advantage over the plaintiff. In the present case, the City lost tax revenue because appellees sold cigarettes to purchasers, but did not report these sales to the State, as required by the Jenkins Act; because of this failure to report, the State was unable to pass on reports of such sales to the City even if it had been inclined to do so; without reports from the State, the City was unable to collect sales taxes from purchasers; concurrently, the purchasers individually opted not to fulfill their tax obligations to the City's taxing authorities. The City was at best an expectant gratuitous donee of information from the State, and the suggestion that the City's harm is somehow less attenuated than the plaintiff's in *Anza* seems to me unsustainable… ." *Nexicon, Inc.,* 541 F.3d at 460.

Winters disagreed with the majority's reading of *Holmes* distinguishing *Anza*, stating, "… even if the *Holmes*' rationale is not completely apt in a particular case, a successful plaintiff must still show that it is a direct victim and, where a statutory violation is alleged to have caused the plaintiff's injury, is a member of the class the particular 'statute meant to protect' and the harm was one 'the statute sought to avoid.' … Moreover, the *Holmes* rationale applies to the present case. My colleagues' view that information provided to the State under the Jenkins Act would in fact be passed along and would, without any cost or friction whatsoever – 'as simple as counting the number of cigarette packs sold by defendants to New York City residents,' … translate into precisely calculable tax revenue recovered from the various addressees is highly exaggerated. … A concern of taxing authorities everywhere is balancing the costs of collection against the recoverable revenue, a matter of great significance where the taxpayers are, as here, anything but inclined toward voluntary compliance. Moreover, the state appears uninterested in enforcing the Jenkins Act and may not collate or maintain accurate records of reports from out-of-state vendors or reliably pass them along. City customers, large numbers of individuals owing relatively small amounts in taxes, may be hard to trace, may assert various defenses in cases based solely on Jenkins Act reports, and may easily use non-City addresses. Finally, as to *Holmes* ... the City hardly has greater incentive to enforce the Jenkins Act through RICO than *Anza*-like competitors who lose sales because of their rivals' sales tax evasion." *Nexicon, Inc.,* 541 F.3d at 461.

In *Hemi Group,* a 5-3 decision, the Supreme Court reversed the Second Circuit (Justice Sotomayor took no part in the consideration or decision of the case as she was on the bench in the Second Circuit when the decision was rendered.) The Court ruled that NYC lacked standing to bring the civil RICO claim as there was not proximate cause. It ruled that the injury suffered by NYC (the lost tax revenues) was not directly caused by the RICO violations. It held that the direct cause of the injury was the failure of the NYC resident purchasers of the cigarettes to pay the cigarette tax. It viewed the RICO violations by Hemi Group of failing to file the Jenkins Act reports as causing harm to NYS as opposed to NYC. Thus, it opined that the failure to pay the tax, which directly caused the injury to NYC, was distinct from the

RICO violations of Hemi Group which gave rise to the fraud and therefore NYC's claim rested on not only separate actions but also separate *actions* committed by separate *parties*. The Court also ruled that NYC's claim that Hemi Group's general "systematic scheme to defraud the city of tax revenue" was the cause of its injury did not allow NYC to avoid the proximate cause requirement. Since the Court ruled that the City failed to establish the proximate cause necessary to show that the lost tax revenues came about *by reason of Hemi* Group's RICO violations, it did not decide whether the lost tax revenue constitutes an injury to *business or property*.

In rendering its decision with regard to proximate cause, the Court first turned to an application of the principles set forth in *Holmes* and found that NYC's theory of proximate cause was "far more attenuated" than the theory that the Court rejected in *Holmes.* NYC's theory of causation rested upon Hemi Group's failure to comply with the Jenkins Act and submit the required customer information to NYS, thus preventing NYS from passing the information to NYC; therefore, since NYC did not receive the customer information, it could not determine which customers failed to pay the tax and it could not pursue them for payment, resulting in the loss of tax revenue. The Court ruled that NYC's theory of causation required it to "move well beyond the first step," thus it failed to satisfy the direct relation requirement for proximate cause in civil RICO claims.

The Court also applied the precedent in *Anza* in reaching its decision that NYC's theory of causation is "far too indirect." It reasoned that the conduct directly causing NYC's injury was the customers' failure to pay the cigarette taxes. However, the conduct constituting the fraudulent RICO violations was Hemi Group's failure to file Jenkins Act reports. Therefore, similar to *Anza,* the activity directly causing the injury was distinct from the activity giving rise to the fraudulent RICO violation.

The Court saw the disconnect between the lost tax revenues and the failure to file the Jenkins reports as even sharper than the disconnect in *Anza,* where the Court viewed the disconnect as a grounds to deny Ideal's civil RICO claim. In *Anza* the same party (National Steel) engaged in the harmful conduct (offering lower prices) and committed the fraudulent RICO violation (by failing to charge and remit sales taxes). In *Hemi Group,* the Court stated, "[T]he City's theory of liability rests not just on separate actions, but separate actions carried out by separate parties. The City's theory thus 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). Indeed, the fourth-party taxpayers here only caused harm to the City in the first place if they decided not to pay taxes they were legally obligated to pay. Put simply, Hemi's obligation was to file the Jenkins Act reports with the State, not the City, and the City's harm was directly caused by the customers, not Hemi. We have never before stretched the causal chain of a RICO violation so far, and we decline to do so today." *Hemi Group,* 130 S. Ct. at 990.

The Court further opined that NYS is better situated than NYC to seek recovery from Hemi Group for the lost tax revenues. It reasoned that NYS's incentive to sue is nearly double NYC's, as it imposes a $2.75 per pack tax on cigarettes, whereas NYC only charges $1.50. While the Court did not opine on whether NYS has standing to bring a civil RICO claim for the lost tax revenues, it did state that it had "concrete incentive to try."

The majority opinion of the Court rebutted the position of the dissent that the proximate cause element in a civil RICO claim turns on foreseeability as opposed to "a direct relationship" between the injury and the predicate act. It noted that the dissent "would find that the City has satisfied that requirement because 'the harm is foreseeable; it is a consequence that Hemi intended, indeed desired; and it falls well within the set of risks that Congress sought to prevent'." *Hemi Group,* 130 S. Ct. at 991. The majority opinion rejected the foreseeability requirement, noting that it did the same in *Anza.* It opined that the Court's precedents clearly established that in RICO cases, "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." *Hemi Group,* 130 S. Ct. at 991.

The Court rejected NYC's argument that the RICO violation was not merely Hemi Group's failure to file Jenkins Act reports with NYS, but a general "systematic scheme to defraud the City of tax revenue." Thus, it held that NYC was not directly harmed *by reason of* the general systematic scheme to defraud. It stated, "[T]he City cannot escape the proximate cause requirement merely by alleging that the fraudulent scheme embraced all those indirectly harmed by the alleged conduct. Otherwise our RICO proximate cause precedent would become a mere pleading rule. In *Anza*, for example, Ideal alleged that National's scheme 'was to give National a competitive advantage over Ideal.' … But that allegation did not prevent the Court from concluding that National's fraud directly harmed only the State, not Ideal. As the Court explained, Ideal could not 'circumvent the proximate-cause requirement simply by claiming that the defendant's aim was to increase market share at a competitor's expense'." *Hemi Group,* 130 S. Ct. at 991. The Court went on to state, in Footnote 1, "Even if we were willing to look to Hemi's intent, as the dissent suggests we should, the City would fare no better. Hemi's aim was not to defraud the City (or the State, for that matter) of tax revenue, but to sell more cigarettes. Hemi itself neither owed taxes nor was obliged to collect and remit them. This all suggests that Hemi's alleged fraud was aimed at Hemi's competitors, not the City. But Anza teaches that the competitors' injuries in such a case are too attenuated to state a RICO claim." *Hemi Group,* 130 S. Ct. at 991.

The Court opined that another reason the direct relationship requirement for proximate cause was not satisfied is that the compensable injury (lost tax revenues) allegedly flowing from the RICO violation was not necessarily the harm caused by the acts. It reasoned that the only fraudulent conduct alleged by NYC in its RICO statement was a violation of the Jenkins Act and NYC could not show that Hemi Group's failure to file the Jenkins reports with NYS led directly to the loss of the tax revenues.

The Court rejected NYC's reliance on *Bridge* to support its claim. It noted that in *Bridge,* the theory of causation was "straight-forward," as the losing bidders "were the *only* parties injured, and Cook County was not, as it received the same revenue regardless of whomever was the winning bidder." Conversely, in *Hemi Group,* it reasoned NYC's theory of causation "is anything but straightforward: Multiple steps, as we have detailed, separate the alleged fraud from the asserted injury. And in contrast to Bridge, where there were 'no independent factors that account[ed] for [the plaintiff's] injury,' … here there certainly were: The City's theory of liability rests on the independent actions of third and even fourth parties." *Hemi Group,* 130 S. Ct. at 992.

The Court disposed of any distinction during the proceedings between NYC describing its injury as the lost "opportunity to tax" rather than "lost tax revenue," noting that it is not clear if there even is a substantive distinction between the two different descriptions and that during the proceedings in the lower courts NYC's claim was based on "lost tax revenue." It reasoned that either way Hemi Group's obligation was to file the Jenkins Act reports with NYS and NYC's injury was caused directly by the purchasers' failure to pay the cigarette taxes. The Court noted that it would not reformulate NYC's merits arguments regardless of how NYC framed its merits arguments. Interestingly, in Footnote 2, the Court stated, "The dissent recognizes that its position poses the troubling specter of turning RICO into a tax collection statute. *Post*, at ____ - ____; 175 L. Ed. 2d, at 963-964 (opinion of Breyer, J.). The dissent's answer looks largely to prosecution policy set forth in the Federal Department of Justice Guidelines, which are, of course, not only changeable, but have no applicability whatever to state or local governments. Under the decision below and the dissent's position, RICO could be used as a tax collection device based solely on the failure to file reports under the Jenkins Act, which itself provides quite limited remedies. See 15 U.S.C. § 377 (providing that a violation of the Jenkins Act may be punished as a misdemeanor with a fine up to $1,000 and imprisonment for no more than six months). And that device

would be available not only to the State, to which the reports were due, but also to the City, to which Hemi owed no duty under the Act and to which it owed no taxes." *Hemi Group,* 130 S. Ct. at 993.

The Court rejected NYC's claim first raised at the Supreme Court level that Hemi Group's affirmative misrepresentations to cigarette purchasers encouraging them not to pay taxes, *e.g.,* informing customers the purchase would be concealed and seeking to convince purchasers that no taxes are owed by claiming the sales are tax-free, are part of the predicate mail and wire fraud RICO violations. It noted that NYC had affirmatively disavowed at the lower court level any reliance on the misrepresentations to form the predicate RICO violation. Rather, NYC used the misrepresentations as evidence of the general scheme to defraud but not as part of the fraud itself. NYC made clear that its RICO claims depended solely on the Jenkins Act violations. The Court opined that it would not consider the alleged misrepresentations as predicate acts at this late stage since NYC defined the predicate acts before the District Court as the failure to file the Jenkins Act reports and expressly disavowed reliance on the alleged misrepresentations.

The majority succinctly concluded its reasoning by stating, "It bears remembering what this case is about. It is about the RICO liability of a company for lost taxes it had no obligation to collect, remit, or pay, which harmed a party to whom it owed no duty. It is about imposing such liability to substitute for or complement a governing body's uncertain ability or desire to collect taxes directly from those who owe them. And it is about the fact that the liability comes with treble damages and attorney's fees attached. This Court has interpreted RICO broadly, consistent with its terms, but we have also held that its reach is limited by the 'requirement of a direct causal connection' between the predicate wrong and the harm. … The City's injuries here were not caused directly by the alleged fraud, and thus were not caused 'by reason of' it. The City, therefore, has no RICO claim." *Hemi Group,* 130 S. Ct. at 994.

Justice Ginsburg joined the majority, concurring in part. Justice Breyer wrote the dissent and was joined by Justice Stevens and Justice Kennedy. The dissent took the position that Hemi Group's failure to file the Jenkins Act reports with NYS proximately caused NYC's lost tax revenues. Underpinning its position, the dissent stated, "We must also assume that Hemi's 'intentiona[l] conceal[ment]' of the name/address/purchase information … is the legal equivalent of an affirmative representation that Hemi had no New York City customers." *Hemi Group,* 130 S. Ct. at 995.

In taking the position that NYC's lost tax revenues was caused *by reason of* Hemi Group's failure to file Jenkins Act reports, the dissent stated, "For one thing, no one denies that Hemi's misrepresentation was a 'but-for' condition of New York City's loss. In the absence of the misrepresentation, i.e., had Hemi told New York State the truth about its New York City customers, New York City would have written letters to the purchasers and obtained a significant share of the tobacco taxes buyers owed. …

"For another thing, New York City's losses are 'reasonably foreseeable' results of the misrepresentation. It is foreseeable that, without the name/address/purchase information, New York City would not be able to write successful dunning letters, and it is foreseeable that, with that information, it would be able to write successful dunning letters. Indeed, that is a natural inference from, among other things, the complaint's assertion that Hemi advertised that it did not 'report' sales information to 'State taxing authorit[ies].' …

"Further, Hemi misrepresented the relevant facts in order to bring about New York City's relevant loss. It knew the loss would occur; it intended the loss to occur; one might even say it desired the loss to occur. It is difficult to find common-law cases denying for a wrongdoer's intended consequences, particularly where those consequences are also foreseeable. …

"In addition, New York City's revenue loss falls squarely within the bounds of the kinds of harms that the Jenkins Act (essentially the predicate statute) seeks to prevent. The statute is entitled 'An Act To assist States in collecting sales and use taxes on cigarettes.'…

"Finally, we have acknowledged that 'Congress modeled § 1964(c) on the civil-action provision of the federal antitrust laws,' and we have therefore looked to those laws as an interpretive aid in RICO cases. … I can find no antitrust analogy that suggests any lack of causation here, nor has the majority referred to any such analogical antitrust circumstance. …

"The upshot is that the harm is foreseeable; it is a consequence that Hemi intended, indeed desired; and it falls well within the set of risks that Congress sought to prevent. Neither antitrust analogy nor any statutory policy of which I am aware precludes a finding of 'proximate cause.' I recognize that some of our opinions may be read to suggest that the words 'by reason of' in RICO do not perfectly track common-law notions of proximate cause. … But where so much basic common law argues in favor of such a finding, how can the Court avoid that conclusion here?" *Hemi Group,* 130 S. Ct. at 996-998.

After presenting its position that the foreseeability standard should be used to establish proximate cause for purposes of civil RICO claims, the dissent presented arguments counterbalancing the position of the majority and attempted to distinguish the majority's use of *Holmes, Anza,* and *Bridge.* Furthermore, since the dissent would find proximate cause, it went on to address the issue of whether NYC's loss of tax revenues is *business or property* for purposes of RICO § 1964 (c) and took the position that it would be.

CONCLUSION

In *Hemi Group,* the Supreme Court recently ruled that New York City lacked standing to bring a civil RICO claim to collect cigarette taxes on internet sales made by out-of-state sellers who failed to file reports with New York State as required by the Jenkins Act. The Court held there was not standing to bring a civil claim under RICO § 1964 (c) by asserting a violation of RICO § 1962 (c) via mail and wire fraud. RICO § 1964 (c) requires that the injuries suffered to business or property be caused *by reason of* the predicate RICO violation, which it ruled was lacking as there was not proximate cause. In ruling on the proximate cause element, the Court used the "direct relationship" standard set forth in its precedents in civil RICO cases rather than the "foreseeability" standard which was sometimes used at common law. It reasoned that there was not a direct relationship between New York City's loss of tax revenue and the failure of the sellers to file the reports. Rather, it was the failure of the purchasers of the cigarettes to pay the tax that caused the direct harm to New York City. Since the Court ruled that proximate cause was lacking, it left open the issue of whether or not the loss of tax revenues is *business or property* for purposes of RICO § 1964(c).

Interestingly, after *Hemi Group* was decided, Congress enacted into law the Prevent All Cigarette Trafficking Act of 2009 (PACT Act), Pub. L. No. 111-154, 124 Stat. 1087 (2010), which is intended to put an end to the evasion of cigarette taxes through online sales and amends the Jenkins Act. The PACT Act imposes an obligation on online sellers to collect state and local taxes prior to delivering the cigarettes ordered via interstate transactions. It requires interstate retail sellers to treat the sales as if they occurred in the state or locality of delivery, thus requiring the seller to comply with all state and local laws. Under the PACT Act, civil damages or injunctions may be sought by both states and localities.

While the PACT Act and the amendments to the Jenkins Act severely curtail the ability to evade taxes on cigarettes via interstate online sales, they also may give localities such as NYC standing to bring a RICO civil claim if the sellers do not collect and remit the taxes prior to delivering the cigarettes. However, that will be left up to the courts to decide. Nevertheless, the Court's holding in *Hemi Group* clarifies the

necessary elements required to satisfy the proximate cause requirement set forth in the *by reason of* language in RICO § 1964(c).

In their never-ending quest to develop novel ways to collect tax revenues, as state and local governments seek to utilize the civil claims provisions of RICO, it is likely that the issue of proximate cause, as ruled on in *Hemi Group,* will continue to face the courts. The Court has clearly established that the "direct relationship standard" will be applied. The issue remains open for the Supreme Court to resolve the split among the circuit courts of appeals on the issue of whether state and local governments may sue under RICO § 1964(c) to collect taxes and similar non-commercial losses incurred by a government acting in its sovereign capacity as injuries to *business or property.* Having ruled on the proximate cause issue in 1992 in *Holmes* and in three of the previous five years (*Anza, 2006; Bridge, 2008; Hemi Group,2010*), it is clear that while the Supreme Court may only hear a limited number of cases, it considers issues regarding proximate cause in civil RICO claims of high importance. Stay tuned!

REFERENCES

Anza, et al. v. *Ideal Steel Supply Corp.*, 547 U.S. 451; 126 S. Ct. 1991; 164 L. Ed. 2d 720 (2006)

Bridge, et al. v. Phoenix Bond & Indemnity Co. et al, 553 U.S. 639; 128 S. Ct. 2131; 170 L. Ed. 2d 1012 (2008)

Canyon County v. Syngenta Seeds, Inc., 519 F.3d 969 (CA-9, 2008), *cert. denied*, 129 S.Ct. 458 (2008)

City of New York v. CYCO.net, Inc. et al., 383 F. Supp. 2d (S.D.N.Y., 2005)

City of New York v. Nexicon, Inc. f/k/a CYCO.net, Inc. et al., No. 03 Civ. 383, 2006 U.S. Dist. LEXIS 10295 (S.D.N.Y., Mar. 15, 2006)

City of New York v. Nexicon, Inc., Hemi Group, LLC., et al., 541 F.3d 425 (CA-2, 2008)

Hawaii v. Standard Oil Co., 405 U.S. 251 (1972)

Hemi Group, LLC, et al. v. City of New York, 129 S. Ct. 2159 (2009)

Hemi Group, LLC and Kai Gachupin v. City of New York, 130 S. Ct. 983 (2010)

Holmes v. Securities Investor Protection Corp., 503 U.S. 258, 112 S. Ct. 1311, 117 L. Ed. 2d 532, (1992)

Illinois Dep't of Revenue v. Phillips, 771 F.2d 312 (CA-7, 1985)

Jenkins Act (15 U.S.C. §§ 375-378)

Michigan Dep't of Treasury u. Fawaz, 653 F. Supp. 141 (E.D. Mich., 1986), *aff'd*, 848 F.2d 194 (CA-6, 1988)

National Bellas Hess, Inc., v. Dept. of Revenue of Ill., 386 U.S. 753 (1967)

Prevent All Cigarette Trafficking Act of 2009, Pub. L. No. 111-154, 124 Stat. 1087 (2010)

Quill Corp. v. North Dakota, 504 U.S. 298 (1992)

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

Township of Marlboro v. Scannapieco, 545 F. Supp. 2d 452 (D. N.J., 2008)

Town of West Hartford v. Operation Rescue, 915 F.2d 92 (CA-2, 1990)

Title IX of the Organized Crime Control Act, Pub. L. 91-542, 84 Stat. 941, as amended, 18 U.S.C. §§ 1961-1968- Racketeer Influenced and Corrupt Organizations Act (RICO)

West Virginia v. Moore, 895 F. Supp. 864 (S.D. W.Va., 1995)