Honest Competitors Catch No Break Under RICO

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The problem of the honest businessperson vexed by competitors who don't play by the rules is a recurrent one in the law. Our model of competition is a vigorous but fair fight for customers' business, with the prizes allocated based on who has the better or more desirable product or service and can offer the best price – or at least the price that represents the best value given the range of quality levels available at different prices. But what happens when one competitor gains an unfair advantage in this contest by ignoring cumbersome or burdensome laws that honest and ethical businesspersons obey?

The remedies are well-known when a competitor focuses unlawful activity directly against his competitor. Familiar laws, such as those against antitrust violations, unfair competition, business torts and the like often provide the answer. But what about the competitor who gets an edge by playing fast and loose not with *your client*, but with *the government* – cheating on taxes to lower his costs, or engaging in regulatory fraud to bypass cumbersome red tape or evade requirements he could not honestly meet? What can the honest businessperson do about that?

Hopes that a creative application of the federal RICO statute might provide a solution to this problem were dealt a sharp blow by the U.S. Supreme Court's recent decision in *Anza v. Ideal Steel Supply Corp*. (June 5, 2006). *Anza* held, in a relatively short opinion by Justice Kennedy, that a private civil RICO claim based on such a theory must fail, because there is a fundamental proximate cause breakdown when fraud is directed at the government while the complained-of injury is borne by the honest competitor.

Anza involved a dispute between two competing steel mill products operations. The plaintiff alleged that the defendants – the principals of the plaintiff's competitor – had adopted a practice of failing to charge the requisite New York sales tax to cash-paying customers, even when conducting transactions that were not exempt from sales tax under state law, and submitted fraudulent tax returns to the New York State Department of Taxation and Finance to conceal this conduct. The plaintiff alleged that this practice allowed the competing business to reduce its prices without affecting its profit margin, with the goal and result of giving the competing business a competitive advantage over the plaintiff.

The plaintiff alleged that defendants, by submitting the fraudulent tax returns by mail or electronically, committed various acts of mail and wire fraud. The plaintiff alleged that these acts of mail and wire fraud were extensive enough to form a RICO "pattern of racketeering activity," and thus sought relief against the defendants under the RICO statute for the business injury the plaintiff claimed it

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had suffered from this alleged pattern of racketeering activity.

The issue posed by the *Anza* appeal was whether the plaintiff's injuries could be said to have been *proximately caused* by the defendants' alleged RICO violations when the fraudulent scheme depended on communications directed to and relied on by a third party rather than the plaintiff. The Supreme Court previously had held in *Holmes v. Securities Investor Protection Corporation*, 503 U.S. 258, 268 (1992), that a civil RICO plaintiff is only able to sue if the alleged RICO violation was the proximate cause of the plaintiff's injury. The defendants asserted that the *Holmes* requirement was not met here.

Looking at *Holmes* in the context of a dispute between two competing businesses as presented by *Anza*, the Court concluded that the proper analysis "begins – and, as will become evident, largely ends – with *Holmes*." According to the Court, *Holmes* had looked to the common-law foundations of the proximate-cause requirement, specifically the "demand for some direct relation between the injury asserted and the injurious conduct alleged," and had held that a civil RICO claim required no less.

Applying those principles to *Anza*, the Supreme Court held that the honest business could not maintain a RICO claim against its dishonest competitor for the kind of injuries claimed in *Anza*. The Court explained that under 18 U.S.C. § 1962(c), the RICO provision that forbids conducting or participating in the conduct of an enterprise's affairs through a pattern of racketeering activity, the compensable injury "is the harm caused by predicate acts sufficiently related to constitute a pattern, for the essence of the violation is the commission of those acts in connection with the conduct of an enterprise" (quoting *Sedima, S.P.R.L. v. Imrex Co*., 473 U.S. 479, 497 (1985)). The problem, said the Court, was that under the plaintiff's theory, the defendants had harmed the plaintiff by defrauding *the New York tax authority* and using the proceeds from the fraud to offer lower prices designed to attract more customers. Thus, while the RICO violation alleged was that the defendants had conducted their company's affairs through a pattern of mail fraud and wire fraud, "[t]he direct victim of this conduct was the State of New York, not [the plaintiff]. It was the State that was being defrauded and the State that lost tax revenue as a result."

The Court acknowledged that the plaintiff had asserted that it had suffered its own harms resulting from the defendants' failure to charge customers for the applicable sales tax, namely plaintiff's own loss of sales resulting from its competitor's decreased prices for cash-paying customers. But, critically, "[t]he cause of [plaintiff's] asserted harms, however, is a set of actions (offering lower prices) entirely distinct from the alleged RICO violation (defrauding the State)," and plaintiff's competitor "could have lowered its prices for any number of reasons unconnected to the asserted pattern of fraud… Businesses lose and gain customers for many reasons, and it would require a complex assessment to establish what portion of [plaintiff's] lost sales were the product of [its competitor's] decreased prices."

The "attenuated connection" between the plaintiff's injury and the defendants' conduct, said the Court, implicates fundamental concerns the Court had expressed when adopting the proximate-cause requirement for civil RICO claims in *Holmes*. The Court pointed in this regard to "the speculative nature of the proceedings that would follow if [the plaintiff] were permitted to maintain its claim," in which a Court would have to determine whether a competitor's lower prices were due to unlawful RICO activity or legitimate and proper commercial competition. "The element of proximate causation recognized in *Holmes*," the Court said, "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." The Court also noted that this causation requirement "is especially warranted where the immediate victims of an alleged RICO violation," *i.e*., the New York State tax authorities, "can be expected to vindicate the laws by pursuing their own claims."

In short, concluded the Court, in circumstances like these, "[a] RICO plaintiff cannot circumvent the proximate-cause requirement simply by claiming that the defendant's aim was to increase market share at a competitor's expense." The judgment of the Court of Appeals, which had allowed the plaintiff's civil RICO claim to proceed, was thus reversed.

Three members of the Court added their own spin to the Court's decision. Justice Scalia penned a short, three-sentence concurrence in which he bluntly declared it to be "inconceivable" that the injury claimed by the plaintiff was "within the zone of interests protected by the RICO cause of action for fraud perpetrated upon New York State." Two other members of the Court, however, took more nuanced positions regarding the plight of the honest competitor.

Justice Thomas wrote a lengthy opinion, concurring and dissenting in part, in which he suggested that civil RICO claims like those of the plaintiff in *Anza* should be actionable in at least some circumstances. Specifically, according to Justice Thomas, "[i]t is not difficult to imagine a competitive injury to a business that would result from the kind of organized crime that [is] recognized as the principal concern of RICO, yet that would fail the Court's restrictive proximate-cause test. For example, an organized crime group, running a legitimate business, could, through threats of violence, persuade its supplier to sell goods to it at cost, so that it could resell those goods at a lower price to drive its competitor out of the business." Justice Thomas argued that the Court's decision had not just eliminated private civil RICO claims in certain situations outside of the core organized-crime focus of RICO, but in fact had "substantially limit[ed] the ability of civil RICO to reach even those cases that motivated Congress' enactment of this provision in the first place."

Justice Breyer likewise concurred and dissented in part, but with a different twist than Justice Thomas, one much less favorable to the injured honest competitor. Justice Breyer's view was that the civil RICO cause of action simply "does not cover claims of injury by one competitor where the legitimate pro-competitive activity of another competitor immediately causes that injury."

Justice Breyer explained that given how the RICO private right of action for treble damages had been modeled on similar provisions in the antitrust laws, a cause should be regarded as indirect and not proximate for RICO purposes "if the causal chain from forbidden act to the injury caused a competitor proceeds through a legitimate business's ordinary competitive activity." Because "[t]he basic objective of antitrust law is to encourage the competitive process," Justice Breyer concluded that RICO should not be read to permit a private civil claim based solely upon a "competitive type of harm, *i.e*., harm a plaintiff suffers only because the defendant was able to attract customers through normal competitive methods, such as lower prices, better products, better methods of production, or better systems of distribution."

Justice Breyer noted that without such a limitation, "RICO enforcement and basic antitrust policy could well collide. Firms losing the competitive battle might find bases for a RICO attack on their more successful competitors in claimed misrepresentations or even comparatively minor misdeeds by that competitor." Thus, Justice Breyer said he would "read into" RICO's private treble-damages provision "a 'proximate-cause' limitation that places outside the provision harms that are traceable to an unlawful act only through a form of legitimate competitive activity."

Civil practitioners have been nothing if not creative over the years in finding new ways to include private civil RICO claims among the arsenal of tools available to persons injured in their businesses by dishonest practices. But in *Anza*, their efforts to harness RICO to help honest businesses who suffer from dishonest competitors who profit from tax or regulatory fraud fell short. The honest competitor may not be utterly without remedies in such situations, but the Supreme Court's latest ruling has made clear that the aggressive protections of the RICO statute will not be among them.

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