No. 16-1309

IN THE

Supreme Court of the United States

S.G.E. MANAGEMENT, L.L.C., ET AL.,
Petitioners,

v.

JUAN R. TORRES, ET AL.,
Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF OF *AMICUS CURIAE* CATO INSTITUTE IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICUS CURIAE*[1]

The Cato Institute is a nonpartisan, public policy research foundation founded in 1977 and dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Center for Constitutional Studies helps restore the principles of constitutional government that are the foundation of liberty. To those ends, Cato holds conferences; publishes books, studies, and the annual *Cato Supreme Court Review*; and files *amicus* briefs.

Consistent with its values, Cato believes strongly that those who engage in fraudulent activity must be held accountable for their actions. It is crucial, however, that the line between fraudulent and legal activity be drawn in a way that respects individual autonomy—holding accountable those who have genuinely harmed others, while not allowing those whose knowing conduct has caused their own loss to use the courts to transfer responsibility to others. This case interests Cato because the Fifth Circuit's failure to account for the limitations imposed by the common-law concept of proximate cause in a civil RICO fraud action blurs rather than clarifies this important line.

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[1] Pursuant to Rule 37.2(a), counsel for all parties received timely notice of *amicus*'s intent to file this brief, and consented in writing. No counsel for any party authored this brief in any part, and no person or entity other than *amicus* or its counsel made a monetary contribution to fund its preparation or submission.

SUMMARY OF ARGUMENT

I. Courts have long recognized that, to respect personal autonomy, there must be a judicially enforceable limit on the "but for" causation test for civil actions. Otherwise, an individual could face unlimited liability for any given act. At the same time, when individuals commit wrongdoing, those injured must be able to hold those actors accountable.

Courts strike a balance between these competing concerns by employing judicial tools known at common law as proximate cause. While these tools are flexible by their nature, so as to adapt to the myriad facts a given case can present, the application of these tools gives alleged tortfeasors and victims alike a sense of predictability, by ensuring that a wrongdoer is liable only for the direct consequences of his actions. In doing so, proximate cause protects the autonomy of all parties involved.

II. In the context of civil RICO fraud, courts, including this one, have consistently assessed proximate cause by considering whether someone relied on an alleged fraudster's misrepresentation, to the victim's detriment. This does not mean that the victim himself must have so relied, but the absence of reliance by *any* party means that the victim's alleged injuries are not the direct result of the fraudster's actions and thus that the common-law proximate-cause requirement is not satisfied. Accordingly, by requiring reliance in the context of civil RICO fraud actions, proximate cause serves the function—as in all tort actions—of ensuring that liability is imposed in a manner that holds all parties responsible for their own actions.

III. The lower court ignored this key safeguard of individual autonomy when it concluded that a plaintiff need not show reliance to establish proximate cause in civil RICO fraud suits. In doing so, the court stacked the deck, not only in favor of calculating individual plaintiffs—wiping away personal accountability from the equation—but also in favor of classes of such plaintiffs under Rule 23. This expansion of liability is particularly troubling in a context where treble damages are available. This Court should grant certiorari to resolve the circuit split in which this error has arisen and thereby confirm the proper role of proximate cause in civil RICO fraud.

ARGUMENT

I. THE COMMON-LAW DOCTRINE OF PROXIMATE CAUSE PROTECTS PERSONAL AUTONOMY FOR ALLEGED TORTFEASORS AND INJURED PARTIES ALIKE.

Anglo-American law has long recognized that "[i]njuries have countless causes, and not all should give rise to legal liability." *CSX Transp., Inc. v. McBride*, 564 U.S. 685, 692-93 (2011) (citing W. Keeton, D. Dobbs, R. Keeton, & D. Owen, Prosser & Keeton on Law of Torts § 42, p. 273 (5th ed. 1984)). Thus, "it has always been the practice of common-law courts (and probably of all courts, under all legal systems) to require as a condition of recovery, unless the legislature specifically proscribes otherwise, that the injury have been proximately caused by the offending conduct." *Holmes v. Secs. Inv'r Prot. Corp.*, 503 U.S. 258, 287 (1992) (Scalia, J., concurring). As Justice Scalia explained in *Holmes*, "[l]ife is too short

to pursue every human act to its most remote consequences; 'for want of a nail, a kingdom was lost' is a commentary on fate, not the statement of a major cause of action against a blacksmith." *Id*.

The "for want of a nail" proverb to which Justice Scalia referred in *Holmes* underscores why judicial limitation on liability is essential to protecting the personal autonomy of the parties on both sides of the "v." in any given case. For example, while it may be true that a major battle might not have been lost but for the failure of the blacksmith to shoe a soldier's horse correctly, neither the deposed king nor other intermediaries hold a cause of action against the blacksmith. A contrary result could make every individual accountable to the entire world for any given action, thereby paralyzing society. At the same time, if an individual horse owner who is directly harmed by a blacksmith's sloppy handiwork could not sue him, the blacksmith would never be held accountable for his own actions.

To strike the appropriate balance between these two extremes, courts use a set of "judicial tools" known generically at common law as "proximate cause." *Id.* at 268 (majority op.). At bottom, proximate cause ensures that there is "some direct relation between the injury asserted and the injurious conduct alleged." *Bridge v. Phoenix Bond & Indem. Co.*, 553 U.S. 639, 654 (2008). In doing so, this common-law doctrine separates cases in which the law seeks to impose liability from those in which, "because of convenience, of public policy, [or] of a rough sense of justice," it does not. *Palsgraf v. Long Island R.R. Co.*, 248 N.Y. 339, 352 (1928). In other words, it makes certain that liability extends only to

those tortfeasors whom the law seeks to hold culpable, and no further. *See Holmes*, 503 U.S. at 268.

By its nature, proximate cause is "a flexible concept that does not lend itself to a black-letter rule that will dictate the result in every case." *Bridge*, 553 U.S. at 654. Its application, however, protects personal autonomy by creating predictability for all parties involved, because the actors know that they are only responsible for the direct consequences of their actions, and those harmed know when they have a reasonable expectation of a remedy. *Id.*

As this Court has recognized repeatedly, Congress imported this common-law principle of proximate cause into the private right of action for treble damages set forth in 18 U.S.C. § 1964(c) of the Racketeer Influenced and Corrupt Organizations Act (RICO). *Bridge*, 553 U.S. at 654; *Anza v. Ideal Supply Corp.*, 547 U.S. 451, 457 (2006); *Holmes*, 503 U.S. at 268. Thus, in a RICO action, as in any other tortious action in which proximate cause "should be evaluated in light of its common-law foundations," a party cannot maintain a cause of action unless there is "'some direct relation between the injury asserted and the injurious conduct alleged.'" *Hemi Grp., LLC v. City of New York*, 559 U.S. 1, 9 (2010) (plurality op.) (quoting *Holmes*, 503 U.S. at 268). And by requiring such a "direct relation"—and therefore excusing a party from liability when an allegation of harm is "too remote," "purely contingent," or "indirect" from the improper conduct—Congress ensured that both alleged defendants and victims remain responsible for their own actions. *Id.*

II. PROXIMATE CAUSE IN RICO FRAUD ACTIONS DEPENDS ON WHETHER SOMEONE DETRIMENTALLY RELIED ON A MISREPRESENTATION MADE BY THE DEFENDANT.

In the context of RICO fraud, both this Court and lower courts have reiterated that the key line of inquiry for identifying whether proximate cause is satisfied—that is, whether there is a "direct relation between the injury asserted and the injurious conduct alleged"—is whether the alleged fraudster made a misrepresentation on which someone relied to the plaintiff's direct detriment. *E.g.*, *Bridge*, 553 U.S. at 654, 656 n.6 (internal quotation marks omitted) ("Of course, a misrepresentation can cause harm *only* if a recipient of the misrepresentation relies on it." (emphasis added)); *Sandwich Chef of Tex., Inc. v. Reliance Nat'l Indem. Ins. Co.*, 319 F.3d 205, 218 (5th Cir. 2003) (cited in *Bridge*, 553 U.S. at 646) ("For a misrepresentation to cause an injury, there *must* be reliance." (emphasis added)).

By requiring reliance when applied in civil RICO fraud suits, common-law proximate cause thus ensures that liability is imposed only to the extent that Congress intended and, in turn, holds both wrongdoers and victims accountable for their actions. As this Court has explained in the context of securities fraud, civil-fraud liability is not meant "to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations *actually cause*." *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 345 (2005) (emphasis added); *see also Basic Inc. v. Levinson*, 485 U.S. 224, 252 (1988) (White, J., concurring in part and dissenting in part)

("[A]llowing recovery in the face of affirmative evidence of nonreliance . . . would effectively convert Rule 10n-5 into a scheme of investor's insurance." (internal quotation marks omitted)); Mark Moller, *The Rule of Law Problem: Unconstitutional Class Actions and Options for Reform*, 28 Harv. J.L. & Pub. Pol'y 855, 861 (2005) (proximate cause "forc[es] courts to distinguish bona fide victims from plaintiffs who simply made poor judgments in transactions and should, therefore, suffer their own losses"). So too in the context of civil RICO fraud: While Congress enacted RICO to protect people who are defrauded and actually harmed as a result of that fraud, it did not through RICO provide insurance to those who invest in a company knowing that it employs a multi-level marketing program and then lose money on that investment.

None of this is to say that first-person reliance is *always* required for the proximate-cause requirement to be met in a RICO fraud action. Such a "black-letter rule" would be at odds both with the Court's holdings in *Holmes* and *Bridge* and the "flexible" nature of proximate cause, as it exists at common law. *Bridge*, 553 U.S. at 654, 655 (internal quotation marks omitted) (rejecting argument that "reliance is an element of a civil RICO claim based on mail fraud"); *CSX Transp.*, 564 U.S. at 693 ("[c]ommon-law 'proximate cause' formulations varied"). Indeed, it is this flexibility that allows courts to respect real-world diversity of circumstances while using common-law proximate cause to give parties the predictability in civil RICO fraud cases that is necessary to avoid infringing individual autonomy.

This Court's ruling in *Bridge* is instructive. In *Bridge*, there was no dispute that the plaintiffs—participants in county tax sales who lost a disproportionate number of bids due to the defendants' alleged mail fraud—did not themselves rely on the defendants' fraudulent misrepresentations. 553 U.S. at 648. Rather, the only party that could have relied on the defendants' misrepresentations was the party that received them and ran the bid process: the county. *Id.*; *see also id.* at 658-59.

This Court nonetheless concluded that there was a "direct relation between the injury asserted and the injurious conduct alleged" such that the defendants could be held liable under RICO. *Id.* at 654, 658 (internal quotation marks omitted). As the Court explained, there were "no independent factors that account for respondents' injury, there [was] no risk of duplicative recoveries by plaintiffs removed at different levels of injury from the violation, and no more immediate victim [was] better situated to sue." *Id.* at 658. Indeed, in *Bridge*, the "respondents and other losing bidders were the *only* parties injured by petitioners' misrepresentations." *Id.* They were "the primary and intended victims." *Id.* at 650. Accordingly, the Court had little trouble concluding that Congress intended to hold the defendants there liable under RICO for their alleged conduct.

In reaching that conclusion, however, the Court made clear that it was not eschewing the requirement that reliance is necessary to comport with proximate cause in civil RICO fraud actions. *Id.* at 658 ("Of course, none of this is to say that a RICO plaintiff who alleges injury 'by reason of' a pattern of

mail fraud can prevail without showing that *someone* relied on the defendant's misrepresentations."). If, for example, the facts turned out to be that the "county knew petitioners' attestations were false but nonetheless permitted them to participate in the auction," such a "complete absence of reliance may prevent the plaintiff from establishing proximate cause." *Id.* at 658-59. The Court merely recognized that, in certain cases (such as in the factual scenario presented in *Bridge*), "first-party reliance" is not "necessary to ensure that there is a sufficiently direct relationship between the defendant's wrongful conduct and the plaintiff's injury to satisfy the proximate-cause principles articulated in *Holmes* and *Anza*." *Id.* at 657-58.

In sum, *Bridge* confirms that in civil RICO fraud actions, the plaintiff, to meet the common-law proximate-cause requirement, must show that someone relied on the alleged fraudster's misrepresentation to the plaintiff's detriment. Absent such reliance, the misrepresentation cannot be said to have caused harm, and thus necessarily did not lead "directly to the plaintiff's injuries." *Id.* at 654, 656 n.6 (internal quotation marks omitted).

III. THE FIFTH CIRCUIT'S DISREGARD OF RELIANCE IN RICO FRAUD SUITS MERITS REVIEW BECAUSE IT OPENS THE DOOR TO UNWARRANTED CLASSES IN TREBLE-DAMAGE CASES.

Notwithstanding *Bridge*'s clear mandate, the Fifth Circuit concluded here, without any reasonable justification, that reliance is *not* necessary to satisfy the common-law proximate-cause requirement in a

civil RICO fraud action. In doing so, the court wiped away the important safeguard of individual autonomy that proximate cause provides in such suits and significantly increased the likelihood of improper class certification—potentially subjecting undeserving defendants to crushing liability under RICO. It is therefore crucial for this Court to review the Fifth Circuit's opinion to restore the proper balance between personal autonomy and accountability promoted by proximate cause.

Here, the plaintiffs sought certification of a class of more than 200,000 individuals who had allegedly lost money investing in Stream Energy. Pet. App. 46a. This putative class includes not only individuals who relied upon an alleged misrepresentation by Stream Energy when they invested, but also individuals who affirmatively did *not* so rely. As Judge Haynes pointed out in dissent, the putative class may include individuals who "could have been fully aware of the questions surrounding Ignite's legality, but nevertheless decided to participate for the simple reason of making a profit." *Id.* at 47a. It also could include individuals who, while aware of the defendant's business model, joined "for the sole purpose of selling (or learning the business of selling) energy," or "solely to take advantage of Ignite's training courses or networking opportunities . . . without any intention of making a profit." *Id.* at 48a. In short, the putative class here includes individuals whose alleged injuries did not "result directly from the defendant's fraudulent misrepresentations," and who therefore cannot meet a genuine common-law proximate-cause requirement. *E.g.*, *Bridge*, 553 U.S. at 653.

Instead of respecting this diversity of circumstances by considering whether putative class members relied on Stream Energy's alleged misrepresentation to their detriment—as required by *Holmes*, *Anza*, and *Bridge*—the Fifth Circuit dispensed with this reliance requirement. It wove out of whole cloth a rule that because the complaint alleged the existence of an illegal pyramid scheme, proximate cause was automatically satisfied *even in the absence of reliance by any party*. Pet. App. 29a-30a. According to the lower court, the "Plaintiffs are necessary to the scheme and are the direct victims of the scheme," and are also "the foreseeable victims of the alleged fraud" because "Pyramid schemes are destined to collapse." Pet. App. 17a. "Whether the Plaintiffs relied on a misrepresentation about the scheme is thus not determinative of whether the Plaintiffs can prove causation under *Bridge*." *Id.*

By refusing to consider whether all members of the class could have relied on Stream Energy's alleged misrepresentations, the Fifth Circuit (joining the Fourth) removed the check on liability that common-law proximate cause provides. As a result, that court no longer requires *all* parties to a RICO fraud action—alleged fraudsters and purported victims alike—to be responsible for their own actions. The deck is now stacked in favor of calculating investors, who have two felicitous courses: (1) Invest and make a profit, and go home happy; or (2) invest and lose money, and then immediately bring a civil RICO fraud action despite having known full well that the company's business was built on a multi-level marketing program. This type of heads-I-win-tails-

you-lose result is the exact scenario that common-law proximate cause seeks to avoid.

Moreover, as the Petition and the Fifth Circuit's own opinion reflect, eschewing reliance as the proper means for determining proximate cause in civil RICO fraud cases paves the path to certification of classes that do not comply with Rule 23's requirements. This is particularly troubling in the RICO fraud context given the availability of treble damages under 18 U.S.C. § 1964(c). As this Court has recognized, civil RICO can be deployed in an "extraordinary, if not outrageous" number of situations, *Sedima, S.P.R.L. v. Imrex Co.,* 473 U.S. 479, 499 (1985), thereby forcing "[m]any a prudent defendant, facing ruinous exposure . . . to settle even a case with no merit, *id.* at 506 (Marshall, J., dissenting). *See also Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 163 (2008) (noting that "extensive discovery and the potential for uncertainty and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies"). By establishing a bright-line rule for civil RICO fraud cases involving alleged pyramid schemes—thereby removing the protective role played by proximate cause and, in turn, exposing defendants to classwide liability that extends beyond "the consequences of that person's own acts," *Holmes*, 503 U.S. at 268—the Fifth Circuit's opinion only heightens these risks.

It hardly follows that a faithful application of the requirement of proximate cause in a civil RICO fraud action would preclude class certification under Rule 23. To the contrary, where, unlike here, a class collectively alleges detrimental reliance on a misrepresentation such that this allegation's "truth

or falsity will resolve" whether proximate cause is satisfied "in one stroke," certification can be appropriate. *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 350 (2011). Such was the case in *Klay v. Humana Inc.*, where the Eleventh Circuit certified a class of doctors who had all been underpaid due to misrepresentations made by health maintenance organizations (HMOs) in "explanation of benefits" forms (EOBs). 382 F.3d 1241 (11th Cir. 2004). Likewise, in *In re U.S. Foodservice Inc. Pricing Litig.*, the Second Circuit certified a class of customers who had all been overcharged by a food distributor's inflated invoices. 729 F.3d 108 (2d Cir. 2013).

The Fifth Circuit cited both of those opinions as support for its decision to provide Plaintiffs with a "rebuttable presumption" of reliance and, thus, causation in civil RICO fraud actions. Pet App. 20a-21a. Unlike here, however, both the Second and Eleventh Circuit cases involved a misrepresentation that, by its nature, presented at least circumstantial evidence of reliance by the entire class. As such, whether the "alleged violation led directly to the plaintiff's injuries" could be answered on a classwide basis in both cases in a way that is not possible here. *Anza*, 547 U.S. at 461. In *Klay*, for example, because of the "nature of the misrepresentations at issue"—the inaccurate EOBs—there existed "circumstantial evidence that can be used to show reliance is common to the whole class." 382 F.3d at 1259. The same is true of *U.S. Foodservice*: Due to the nature of the misrepresentation (inaccurate invoices), the court concluded that the food servicers had presented "circumstantial proof of reliance based on the reasonable inference that customers who pay the

amount specified in an inflated invoice would not have done so absent reliance upon the invoice's implicit representation that the invoiced amount was honestly owed." 729 F.3d at 120; *see also* Pet. at 15-16 (recognizing *U.S. Foodservice* as among the Second Circuit decisions continuing to require reliance).

The Fifth Circuit made no such inquiry into reliance here, thus opening the door to Rule 23 certification in civil RICO fraud suits based upon a rebuttal presumption—rather than either an affirmative demonstration or circumstantial case—of causation. This Court should intervene to correct that significant error.

CONCLUSION

For the foregoing reasons, the Court should grant the petition for a writ of certiorari.

Respectfully submitted,

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