359 F.3d 171, RICO Bus.Disp.Guide 10,628, 63 Fed. R. Evid. Serv. 893
(Cite as: 359 F.3d 171)

United States Court of Appeals,
Second Circuit.
BANK OF CHINA, NEW YORK BRANCH, Plaintiff–Appellee,
v.
NBM LLC, Yang Mei Corp., GEG International Inc., BOC Company, Non–Ferrous BM Corporation, Shumin Wang, John Chou, Dao Zhong Liu, CBL Ltd. a/k/a CBL Investment Company Grand Cayman, and Century Ltd., Defendants–Counter–Claimants–Appellants,
RCHFINS, Inc., Defendant–Appellant,
Sherry Liu, a/k/a Sherry Ping Liu, Defendant–Third–Party–Plaintiff–Appellant,
Bank of China, Hong Kong Branch, a/k/a Bank of China (Hong Kong) Limited, Kwangtung Provincial Bank, Bank of China, Tokyo Branch, Bank of China, Cayman Islands Branch, PO Sang Bank Ltd., Bank of China, Third–Party–Defendants,
C.H.G. Enterprises, Inc., National Budget Merchandise Inc., Sino–Place Alliance, Inc., BHK LLC, Minkang GU, Linda Xiao, Helen Zhou, Patrick Young, John and Jane Does 1–200, Sinco Trust Ltd., a/k/a Synco Trust, IFB Inter Establishment, Sunleaf, Inc., Beda A. Singerberger, Defendants,
Hui Liu, Defendant–Counter–Claimant.

Docket No. 02–9267.
Argued Nov. 3, 2003.
Decided Feb. 17, 2004.

SCHEINDLIN, District Judge.

NBM LLC, Yang Mei Corporation, GEG International, Incorporated, BOC Company, Non–Ferrous BM Corporation, Shumin Wang, John Chou, Dao Zhong Liu, CBL Limited, Century Limited, RCHFINS Incorporated, and Sherry Liu ("Appellants") appeal from a decision of ***174** the United States District Court for the Southern District of New York (Denny Chin, *Judge*) denying them judgment as a matter of law following a jury verdict entered in favor of Bank of China, New York Branch. Bank of China alleged that Appellants, together with numerous non-appealing defendants, engaged in a scheme to defraud the Bank out of millions of dollars.

At trial, the jury found that all defendants were unjustly enriched at Bank of China's expense, committed fraud against Bank of China, and violated section 1962(d) of the Racketeer Influenced and Corrupt Organizations Act ("RICO"). The jury further found that defendants NBM LLC and Yang Mei Corporation breached loan agreements with Bank of China, that non-appealing defendant Patrick Young breached his fiduciary duties to the Bank, that defendants John Chou, Sherry Liu, NBM LLC, Yang Mei Corporation, BOC Company, and RCHFINS aided and abetted Young in breaching his fiduciary duties, and that defendants John Chou, Sherry Liu, NBM LLC, Yang Mei Corporation, GEG International, BOC Company, CBL Limited, Century Limited, and RCHFINS violated section 1962(c) of RICO. The jury awarded approximately $132 million to Bank of China, including $35.4 million in compensatory damages and a total of $96.4 million in punitive damages.

On September 11, 2002, Judge Chin denied defendants' motion to set aside the verdict. *See Bank of China, New York Branch v. NBM, L.L.C.*, No. 01 Civ. 0815, 2002 WL 31027551 (S.D.N.Y. Sept.11, 2002). On September 13, 2002, the District Court entered judgment in favor of Bank of China, against NBM, Yang Mei, RCHFINS, John Chou, Sherry Liu, GEG, BOC, CBL, Century, Shumin Wang, Dao Zhong Liu, Helen Zhou, Hui Liu, Patrick Young, National Budget, CHG, BHK, Sino–Place, and Sunleaf, jointly and severally, in the amount of $106,361,504.40. This amount equaled $35,453,834.80 in compensatory damages, trebled pursuant to section 1964(c) of RICO.[FN1] Appellants now appeal, arguing that the District Court committed various errors that deprived the defendants of a fair trial.

FN1. In its Memorandum and Order dated September 10, 2002, the District Court explained that this was the maximum amount the plaintiff could recover on any of the causes of action because the plaintiff could not recover both punitive damages, and treble damages.

I. BACKGROUND

Bank of China alleged that the defendants defaulted on their loan obligations and perpetrated a massive fraud on Bank of China, beginning in 1991 and continuing until mid–2000. In sum, Bank of China claimed that various defendants borrowed huge sums from the Bank through false and misleading representations, and in many cases, forged documents. In violation of representations and contractual undertakings, the borrowed funds were converted into different currencies and transferred into accounts held by other defendants, which were represented to the Bank to be independent businesses; in fact, the "third-party businesses" were controlled by the borrowing defendants. The borrowed funds were then falsely represented to Bank of China to be "trade debt" owed to the borrowing defendants, thus creating the illusion that the borrowing defendants and the "third-party businesses" were thriving businesses with sufficient cash flows to sustain the borrowing limits approved by the Bank. The borrowed funds were also disguised as "collateral" for further loans, creating further indebtedness to the Bank. Finally, additional monies were drawn down against ***175** letters of credit issued under the increased credit facilities by the presentation of false and forged documents for non-existent transactions. The success of the fraud was dependent, in part, on bribes paid to defendant Patrick Young, then a deputy manager at Bank of China who handled defendants' transactions with the Bank.

II. DISCUSSION

Appellants argue that there was insufficient evidence to support the jury's verdict, and that the District Court committed numerous errors constituting abuses of discretion, thereby depriving the defendants of a fair trial. We conclude that two of Appellants' arguments are meritorious, and address each of those arguments in turn.

A. Jury Instructions

On the last day of trial, defendants requested that the Court instruct the jury that if senior Bank management knew of defendants' activities, that knowledge must be imputed to the Bank. As a result of its own research, the District Court concluded that defendants' proposed instruction misstated the law, and that the law was, in fact, the opposite of defendants' proposition. In so finding, the District Court relied on *United States v. Rackley,* 986 F.2d 1357, 1361 (10th Cir.1993) (upholding bank fraud conviction where the owner and director of the bank knew of the fraudulent activity); *United States v. Weiss,* 752 F.2d 777, 783–84 (2d Cir.1985) (upholding mail fraud conviction where the defendant argued that the illegal scheme was "presumptively used for the benefit of the corporation"); *United States v. Yarmoluk,* 993 F.Supp. 206, 209 (S.D.N.Y.1998) ("[A]n institution may be defrauded even if its employees allow or participate in the fraudulent practices."). The District Court noted that it relied on criminal cases rather than civil cases, but found this distinction irrelevant because there is no difference between criminal bank fraud and bank fraud as a predicate act in a civil RICO claim. *See* Trial Transcript ("Tr." at 1744–45). The District Court also observed that general agency law would not support the defendants' proposed instruction because it is well established that when an agent acts adversely to its principal, the agent's actions are not imputed to the principal. *See Wight v. BankAmerica Corp.,* 219 F.3d 79, 87 (2d Cir.2000).

The District Court therefore instructed the jury as follows:

> [T]he bank is also an entity, a financial institution, as opposed to an individual, and it also must act through natural persons as its agents and employees. Now, certain defendants have argued that certain agents and employees of the bank knew of the true nature of the transactions in question, and that therefore the bank could not have been the victim of fraud. I instruct you that an institution may be defrauded, even if its agents and employees permitted or participated in the fraud. Where a financial institution is defrauded by an outsider working with agents and employees of that institution, it is the institution, not its agents or employees, that is the victim of the fraud. Accordingly, even if certain officers of the bank knew the true nature of the transactions, the bank nevertheless could have been defrauded. It is up to you, of course, to determine whether the bank has proven fraud by clear and convincing evidence.[FN2]
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> FN2. Although the District Court derived this instruction from criminal bank fraud law, the Court gave the instruction to the jury in the context of the common law fraud instruction rather than the civil RICO bank fraud instruction.

Tr. at 1872.

Appellants maintain that this instruction was erroneous because it relieved the ***176** Bank of its burden of proving reliance. Specifically, Appellants argue that the instruction precluded the jury from considering their defense that the actions complained of were sanctioned and authorized by the Bank's officers, and that therefore the Bank could not have detrimentally relied on any of the defendants' representations.

1. Standard of Review

"A jury instruction is erroneous if it misleads the jury as to the correct legal standard or does not adequately inform the jury on the law." *Anderson v. Branen,* 17 F.3d 552, 556 (2d Cir.1994). "An instruction must [ ] allow the jury to adequately assess evidence relied on by a party." *District Council 37, Am. Fed'n of State, County & Mun. Employees, AFL–CIO v. New York City Dep't of Parks and Recreation,* 113 F.3d 347, 355 (2d Cir.1997) (citing *Carvel Corp. v. Diversified Mgmt. Group,* 930 F.2d 228, 231–32 (2d Cir.1991)). "An erroneous instruction requires a new trial unless the error is harmless. An error is harmless only if the court is convinced that the error did not influence the jury's verdict. If an instruction improperly directs the jury on whether the plaintiff has satisfied her burden of proof, it is not harmless error because it goes directly to the plaintiff's claim, and a new trial is warranted." *Gordon v. New York City Bd. of Educ.,* 232 F.3d 111, 115–16 (2d Cir.2000) (citations and quotation marks omitted); *see also Girden v. Sandals Int'l,* 262 F.3d 195, 203 (2d Cir.2001) ("A new trial is required if, considering the instruction as a whole, the cited errors were not harmless, but in fact prejudiced the objecting party."). Therefore, we will reverse a judgment because of an error in the jury instructions if the charge given was incorrect and did not sufficiently cover the "essential issues." *Carvel,* 930 F.2d at 231. *See also Plagianos v. Am. Airlines, Inc.,* 912 F.2d 57, 59 (2d Cir.1990) (when jury instructions, "taken as a whole," give the jury "a misleading impression or inadequate understanding of the law, a new trial is warranted"). We review *de novo* a district court's jury instructions. *Anderson,* 17 F.3d at 556.

2. Civil RICO Plaintiffs Alleging Fraud As Predicate Acts Must Establish Reliance

The civil RICO statute, 18 U.S.C. § 1964(c), specifies that "[a]ny person injured ... by reason of a violation of [§ 1962] may sue therefor ... and ... recover threefold the damages he sustains." In *Holmes v. Sec. Inv. Prot. Corp.,* 503 U.S. 258, 112 S.Ct. 1311, 117 L.Ed.2d 532 (1992), the Supreme Court held that the "by reason of" language in section 1964(c) means that in order to prevail on a civil RICO claim, the plaintiff must show that the defendant's violation was the "proximate cause" of the plaintiff's injury. *See id.* at 268. It is well established in this Circuit that where mail fraud is the predicate act for a civil RICO claim, the proximate cause element articulated in *Holmes* requires the plaintiff to show "reasonable reliance." In *Metromedia Co. v. Fugazy,* 983 F.2d 350 (2d Cir.1992), decided after *Holmes,* we noted that, "[i]n the context of an alleged RICO predicate act of mail fraud, we have stated that to establish the required causal connection, the plaintiff was required to demonstrate that the defendant's misrepresentations were relied on." *Id.* at 368 (citations omitted).

Several of our sister Circuits have concluded that where common law, wire or securities fraud are the predicate acts for ***177** a civil RICO action, the plaintiff must establish "reasonable reliance." *See Summit Props. Inc. v. Hoechst Celanese Corp.,* 214 F.3d 556, 562 (5th Cir.2000) ("when civil RICO damages are sought for injuries resulting from fraud, a general requirement of reliance by the plaintiff is a commonsense liability limitation"); *Appletree Square I, Ltd. P'ship v. W.R. Grace & Co.,* 29 F.3d 1283, 1286 (8th Cir.1994) ("In order to establish injury to business or property 'by reason of' a predicate act of mail or wire fraud, a plaintiff must establish detrimental reliance on the alleged fraudulent acts."); *Caviness v. Derand Res. Corp.,* 983 F.2d 1295, 1305 (4th Cir.1993) ("claim under [civil] RICO requires both reliance and damage proximately caused by the violation"). [FN3] However, neither this Circuit, nor any other Circuit or district court, has explicitly addressed whether the plaintiff must show "reasonable reliance" where the predicate act alleged is bank fraud.[FN4]

FN3. In crafting jury instructions, many district courts rely on *Modern Federal Jury Instructions. See* Leonard B. Sand, et al., *Modern Federal Jury Instructions* (2003). Yet, despite *Holmes* and the trend among the Circuits interpreting *Holmes* to require a showing of "reasonable reliance" in civil

> RICO actions predicated on fraud, *Modern Federal Jury Instructions* does not address *Holmes* or its progeny. *See id.* ch. 84. Instead, the introductory section on civil RICO in *Modern Federal Jury Instructions* merely notes that section 1964(c) permits persons injured by violations of section 1962 of Title 18 to bring a civil action. *See id.* ch. 84.01. The treatise goes on to provide model instructions for civil actions predicated on sections 1962(a)-(d); none of these model instructions address section 1964(c) or its requirements. Because the *Holmes* "proximate cause" requirement is derived from section 1964(c), not section 1962, courts relying exclusively on the current edition of *Modern Federal Jury Instructions* will fail to instruct juries with respect to the "proximate cause" requirement. Though this failure may not always constitute reversible error, *see, e.g., Metromedia,* 983 F.2d at 368 (noting that "it would have been preferable to have included an instruction that informed the jury of the relationship between causation and reliance," but declining to reverse the jury verdict because there was substantial evidence in the record that the plaintiff relied on the defendant's representations), it would be wise for district courts to include a charge requiring a plaintiff to prove that she reasonably relied to her detriment on the defendant's fraudulent acts or omissions.
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> FN4. The bank fraud statute provides:
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> > Whoever knowingly executes, or attempts to execute, a scheme or artifice—(1) to defraud a financial institution; or (2) to obtain any of the moneys, funds, credits, assets, securities, or other property owned by, or under the custody or control of, a financial institution, by means of false or fraudulent pretenses, representations, or promises; shall be fined not more than $1,000,000 or imprisoned not more than 30 years, or both.
> >
> > 18 U.S.C. § 1344.

Bank fraud is a somewhat different type of fraud than common law, securities, mail and wire fraud because the bank fraud statute was designed to protect the integrity of the federally insured banking system. *See Rackley,* 986 F.2d at 1361 ("Section 1344 was intended to reach a wide range of fraudulent activity that undermines the integrity of the federal banking system." (citations omitted)); *see also* S.Rep. No. 98–225, at 377 (1983) *reprinted in* 1984 U.S.C.C.A.N. 3182, 3517 (section 1344 was "designed to provide an effective vehicle for the prosecution of frauds in which the victims are financial institutions that are federally created, controlled, or insured."). However, the fact that the criminal bank fraud statute serves to protect the federal banking system does not affect the *Holmes* "proximate cause" requirement: plaintiffs who bring civil actions pursuant to section 1964(c) are required to establish that the defendants' actions were the proximate cause of plaintiffs'***178** injuries regardless of whether the predicate act alleged is bank fraud or some other conduct defined as a RICO predicate act in section 1961(A) of Title 18 of the United States Code. This result is perfectly reasonable. Unlike a *criminal* bank fraud prosecution, which serves to protect the integrity of the federally insured banks, a *civil* RICO action predicated on bank fraud is intended to compensate the plaintiff-victim for its losses. If the plaintiff-victim cannot establish that the defendants' actions caused the losses, no recovery is appropriate or warranted.

We therefore now hold that in order to prevail in a civil RICO action predicated on any type of fraud, including bank fraud, the plaintiff must establish "reasonable reliance" on the defendants' purported misrepresentations or omissions. Thus, Bank of China was required to prove that it reasonably relied on defendants' purported misrepresentations—i.e., the representations that the defendants made to the Bank in order to obtain the loans.

3. The Jury Instructions Were Erroneous

The District Court's instruction to the jury that a bank may be defrauded regardless of whether its officers and employees are aware of, and participate in the fraud, was derived from criminal bank fraud case law. This was error. There is a conceptual difference between criminal bank fraud and bank fraud as a predicate for a civil RICO action. In a criminal bank fraud prosecution, the Government need not prove that any individual or institution relied on the defendant's purported misrepresentations, whereas in a

civil RICO action predicated on bank fraud, the plaintiff must demonstrate "reasonable reliance." Nowhere did the District Court instruct the jury that in determining whether the defendants had committed a civil RICO violation, [FN5] it must consider and determine whether or not the Bank reasonably relied on the defendants' purported misrepresentations.[FN6]

FN5. The alleged predicate acts were mail, wire and bank fraud. Though we previously have held that a plaintiff seeking to recover in a civil RICO action predicated on mail fraud must establish "reasonable reliance" by the plaintiff, *see* *Metromedia Co.*, 983 F.2d 350, the District Court did not so instruct the jury.

FN6. The District Court instructed the jury that in order to prevail on its RICO claims, the Bank was required to prove that its injury was "proximately caused by the defendants in violation of RICO. An injury or damage is proximately caused when a wrongful act played a substantial part in bringing about or actually causing injury or damage, and that the injury or damage was either a direct result or a reasonably probable consequence of the act." Tr. at 1886. However, the District Court failed to instruct the jury that in order to establish that the defendants' acts proximately caused its injuries, the Bank was required to prove that it "reasonably relied" on the defendants' fraudulent acts.

Moreover, because the erroneous instruction derived from criminal bank fraud law was inexplicably given as part of the common law fraud charge [FN7] rather than the civil RICO charge, it tainted the fraud charge.[FN8] In its instructions on common law fraud, the District Court instructed the jury that Bank of China was required to prove "reliance." However, this instruction *immediately* preceded the erroneous instruction derived from criminal bank fraud case law, which essentially eviscerated the reliance requirement—the ***179** jury was told that Bank of China was required to prove "reliance" for the Bank to prevail on the common law fraud claim, but it was *also* told that even if the officers and employees of the Bank knew of and participated in defendants' fraudulent activities, and therefore could not have relied on the alleged misrepresentations in granting the loans, the Bank nonetheless could be defrauded. *See* Tr. at 1867–1872; *supra* Part II.A.

FN7. Bank of China's common law fraud claim was separate from its civil RICO claim, and was not alleged as a predicate act.

FN8. Of course, the instruction would have been incorrect even if given as part of the civil RICO charge because it misstated the law, but its effect would not have been as damaging.

These two instructions are at best confusing, and at worst irreconcilable. As an entity, the Bank acts only through its officers and employees.[FN9] *See* *Cedric Kushner Promotions, Ltd. v. King*, 533 U.S. 158, 166, 121 S.Ct. 2087, 150 L.Ed.2d 198 (2001); *Suez Equity Investors, L.P. v. Toronto–Dominion Bank*, 250 F.3d 87, 101 (2d Cir.2001). Thus, the Bank cannot rely on misrepresentations unless its agents or employees rely on those misrepresentations. It follows that if the Bank's officers were aware of, and participated in the defendants' allegedly fraudulent activities, then neither they, *nor the Bank* relied on the purported misrepresentations in granting loans to the defendants. By instructing the jury that the Bank could be defrauded even if its employees knew of or participated in the defendants' scheme, the District Court therefore relieved Bank of China of its burden to prove "reasonable reliance," an element of common law fraud and, as we now hold, the RICO predicate acts of mail, wire and bank fraud.

FN9. The District Court instructed the jury that certain of the *defendants* are corporations, and that as corporations, those defendants act only through their agents or employees. *See* Tr. at 1871. Although the District Court did note that the *plaintiff* is also an entity that acts only through its agents and employees, this instruction had essentially no effect because it was given in the context of the erroneous instruction—the jury was instructed that the Bank acts only through its agents or employees, but the Bank nonetheless could rely on representation and be defrauded even if the Bank's agents and employees did not rely on the misrepresentations. *See* jury instruction, *su-*

pra Part II.A.

Finally, the District Court correctly noted, during a conference with counsel, that when an agent acts adversely to its principal, the agent's actions and knowledge are not imputed to the principal. *See* Tr. at 1741; *see also* *Wight,* 219 F.3d at 87 ("[T]he adverse interest exception rebuts the usual presumption that the acts and knowledge of an agent acting within the scope of employment are imputed to the principal.... [M]anagement misconduct will not be imputed to the corporation if the officer acted entirely in his own interests and adversely to the interests of the corporation."). But the jury was never instructed on this fundamental principle. The doctrine, referred to as the "adverse interest exception," is entirely consistent with our present holding because it "is narrow and applies only when the agent has 'totally abandoned' the principal's interests." *Id.* (quoting *In re Mediators, Inc.,* 105 F.3d 822, 827 (2d Cir.1997)). Thus, if Bank of China's officers or employees were aware of, or participated in, defendants' scheme, their knowledge would be imputed to the Bank *unless* the employees' actions exhibited a "total abandonment" of Bank of China's interests. This clearly raises an issue of fact for the jury to decide. An appropriate instruction, given in conjunction with a "reasonable reliance" instruction for both the common law fraud and civil RICO claims, should have guided the jury in making this determination.

4. The Error Necessitates Reversal

Considering the charge as a whole, the District Court's instructions misstated the law. The charge was erroneous because***180** it failed to inform the jury of an essential element of a civil RICO action predicated on fraud, and inaccurately instructed the jury with respect to the common law fraud claims. As a result, Bank of China was not required to sustain its burden of proof, and defendants were not able to put their defense before the jury. Under these circumstances, we cannot conclude that the error was harmless because we are not "convinced that the error did not influence the jury's verdict." *Gordon,* 232 F.3d at 115–16.

At trial, defendants introduced evidence that throughout the period they obtained loans from Bank of China, they socialized extensively with officers of the Bank and spent time with the officers in the Cayman Islands. According to defendants, these officers were intimately familiar with the defendants' transactions. Defendants presented further evidence that essentially every manager and deputy manager with whom the defendants dealt at the New York Branch was terminated, demoted or transferred out of that Branch following the Bank's internal investigation of defendants' transactions. *See* Tr. 435–50, 460–63, 486–90, 648–49. Bank of China did not call the transferred and terminated employees as witnesses, and because all of the employees are outside the District Court's subpoena power, the defendants were unable to call them. Huang Yangxin, the only Bank of China employee who testified, did not work in the New York Branch during most of the period that the defendants obtained loans from the Bank, and therefore he had no knowledge of various meetings regarding the transactions that defendants contend they had with New York Branch officers. Thus, there certainly was evidence from which the jury could have inferred that the Bank's employees or agents were aware of the defendants' purportedly fraudulent representations, and that therefore, the Bank did not rely on the representations. However, the jury charge did not require Bank of China to prove that it relied on the misrepresentations or that the officers were acting *ultra vires.* As a result of the erroneous jury instruction, the jury was precluded from even considering this defense. Thus, because the jury charge "d[id] not adequately inform the jury on the law," *Anderson,* 17 F.3d at 556, and "improperly direct[ed] the jury on whether the plaintiff [ ] satisfied [its] burden of proof, it is not harmless error ...". *Gordon,* 232 F.3d at 115–16 (citations and quotation marks omitted).

Finally, the error is particularly troubling in the context of a civil RICO action, where defendants are subject to treble damages. Accordingly, we reverse the judgment and remand for a new trial.

* * * *

III. CONCLUSION

For the foregoing reasons, the judgment is VACATED and REMANDED to the District Court for further proceedings consistent with this Opinion.

C.A.2 (N.Y.),2004.
Bank of China, New York Branch v. NBM LLC
359 F.3d 171, RICO Bus.Disp.Guide 10,628, 63 Fed. R. Evid. Serv. 893