Wagh v. Metris Direct, Inc. (Nov. 7, 2003): **The Ninth Circuit Wisely Dismisses Civil RICO Claims under Section 1962(a) and (b), but Affirms the "Result-Oriented" Racketeering Activity / Enterprise Distinction Under Section 1962(c).**

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Wagh was the holder of a consumer credit card issued by Citibank. Metris is a "credit protection" organization. In his complaint, Wagh alleged that Metris caused Citibank to bill Wagh $119.95 even though Wagh had not contracted for membership with Metris. Wagh brought several common law claims against Metris. He also brought claims against Metris under various California statutes and under the federal RICO Act, sections 1962(a), (b), (c) and (d).

Wagh's complaint was originally filed in state court but removed to federal court by Metris. Wagh's RICO claim was the only basis for federal subject matter jurisdiction. The district court eventually dismissed all of Wagh's RICO claims with prejudice and remanded the action to state court. Wagh appealed to the United States Court of Appeals for the Ninth Circuit.

Failure to Plead with Specificity

The Ninth Circuit noted that the general problem with Wagh's complaint was that he failed to plead Metris' racketeering activity with specificity. Wagh's failure not only violated Rule 9(b) but also violated a standing order of the district court. Rather than claiming to have abided by the standing order, Wagh challenged whether the standing order could be applied in any case – arguing that the standing order could not be enforced because it was in conflict with Rule 8(a). Rule 8(a) requires that a complaint make "a short and plain statement of the claim showing that the pleader is entitled to relief."

The Ninth Circuit rejected Wagh's challenge, noting the inherent tension between the particularity requirement of Rule 9(b) and the "short and plain" requirement of Rule 8(a). The court also discussed and sided with the many other circuit courts of appeal who have upheld the enforceability of similar standing orders. *See, e.g., Figueroa Ruiz v. Alegria*, 896 F.2d 645, 646 (1st Cir. 1990); *Old Time Enterps. V. Int'l Coffee Corp.*, 862 F.2d 1213, 1217 (5th Cir. 1989); *Commercial Cleaning Services, L.L.C. v. Colin Service Systems, Inc.*, 271 F.3d 374, 385 (7th Cir. 2001).

Regardless of the complaint's lack of specificity, the Ninth Circuit held that Wagh's RICO claims were fundamentally flawed on a substantive basis and that the district court not only correctly dismissed the claims but also correctly denied Wagh's request for leave to amend.

Section 1962(a) and (b) Claims: No Proximate Cause

The district court dismissed Wagh's claims under sections 1962(a) and (b) on the basis that Wagh's alleged injuries were caused "by reason of" Metris' alleged acts of racketeering, which would be recoverable only under section 1962(c). To have standing under section 1962(a), the district held that a plaintiff must be injured "by reason of" the defendant's investment in the enterprise, and under section 1962(b), a plaintiff must be injured "by reason of" the defendant's acquisition or maintenance of control of an enterprise.

On appeal, Wagh argued that the district court erred in its application of section 1964(c)'s "by reason of" language. Wagh argued that the district court should have followed the logic of *Busby v. Crown Supply Inc.*, 896 F.2d 833 (4th Cir. 1990), which held that, to have standing under section 1962(a), a plaintiff "need only allege that he was injured by the use or investment of funds previously received from others in violation of the mail fraud, wire fraud, and RICO statutes, and . . . that the [defendants] 'reinvest in themselves' the income generated by 'the enterprise's pattern of racketeering activity.'" The Ninth Circuit rejected Wagh's argument and reaffirmed its holding in *Nugget Hydroelectric L.P. v. Pacific Gas & Elec. Co.*, 981 F.2d 429 (9th Cir. 1992): "'the acquisition and reinvestment of the proceeds of racketeering activity in the general affairs of the enterprise' does not qualify as an investment injury" under section 1962(a).

The Ninth Circuit held that just as Wagh's injuries were not caused by Metris' investment in the enterprise, the injuries were also not caused by Metris' acquisition or maintenance of control over the enterprise. According to the Ninth Circuit, a plaintiff has standing under section 1962(b) only if it alleges injury "resulting from the defendant's control or acquisition of a RICO enterprise."

Section 1962(c): No Distinction Between Racketeering Activity and Enterprise

In dismissing Wagh's claim under section 1962(c), the Ninth Circuit relied on the widely accepted principle that the racketeering activity, under section 1962(c), must be distinct from the enterprise. The enterprise alleged by Wagh was an association-in-fact enterprise consisting of Metris, two of its employees and Citibank. The Ninth Circuit held that Wagh's section 1962(c) claim was fatally flawed because the enterprise was not distinct from the alleged pattern of racketeering:

> [Wagh] has not alleged that [Metris] and Citibank have established a system of making decisions in furtherance of their alleged criminal activities, independent from their respective regular

> business practices. Nor has [Wagh] alleged that an independent system of distributing the proceeds of money obtained from persons like Wagh exists between [Metris] and Citibank.

Without a substantive RICO violation under section 1962(a), (b) or (c), there could be no conspiracy claim under section 1962(d).

GOOD LAW vs. BAD LAW

Good Law: The Ninth Circuit rightfully reaffirmed the practical obsolescence of civil RICO claims under section 1962(a) and (b). If "reinvestment" injuries were adequate to confer standing under section 1962(a), civil RICO claims would be twice as complicated as they are now, and if a similar theory were allowed under section 1962(b), civil RICO would be three times as complicated. Every fact scenario would give rise to claims under all three of section 1962's subdivisions.

Section 1962(a) essentially prohibits money laundering. Section 1962(b) essentially prohibits loan sharking or extortion activities that result in organized crime taking over legitimate business. Section 1962(a) and (b) are useful in the criminal context, but in the civil context, almost all economic losses are caused by the acts of racketeering themselves. Section 1962(a) and (b) are usually no more than two additional pellets in the shell of a plaintiff attorneys' shot-gun pleadings. They seldom if ever bear any weight. *See also Lightening Lube, Inc. v. Witco Corp.*, 4 F.3d 1153, 1188 (3d Cir. 1993); *St. Paul Mercury Ins. Co. v. Williamson*, 224 F.3d 425, 441 (5th Cir. 2000); *Grider v. Texas Oil & Gas Corp.*, 868 F.2d 1147, 1149 (10th Cir.), *cert. denied*, 493 U.S. 820 (1989); *Simon v. Value Behavioral Health, Inc.*, 208 F.3d 1073, 1083 (9th Cir. 2000), *cert. denied*, 531 U.S. 1104 (2001); *Advocacy Organization for Patients and Providers v. Auto Club Ins. Ass'n*, 176 F.3d 315, 329 (6th Cir. 1999); *Crowe v. Henry*, 43 F.3d 198, 205 (5th Cir. 1995); *but see In re Sahlen & Assoc., Inc. Sec. Litig.*, 773 F. Supp. 342, 366-67 (S.D. Fla. 1991).

Bad Law: Although widely accepted, the racketeering activity / enterprise distinction under section 1962(c) is not an intellectually honest standard. The distinction seems to be relied upon as a "judicial tool" that a court can use to get rid of a civil RICO claim that it doesn't like, i.e., a civil RICO claim predicated on weak or tenuous allegations of mail or wire fraud. To understand the intellectual dishonesty of the standard, one need only consider its application to the Mafia, the very enterprise that the RICO Act was designed to address. Is the Mafia distinct from the acts of racketeering that it engages in? Does the Mafia have activities that are distinct or independent from its criminal activities? If the Mafia owns legitimate businesses, the businesses are usually used to launder money and are not wholly distinct from the criminal acts. Does the Mafia have an independent system of distributing the proceeds of its racketeering? In order to

be intellectually honest, the racketeering activity / enterprise distinct should apply in all RICO claims. It is hard to image that any court would, however, dismiss a RICO claim against a Mafia member because there was no distinction between the Mafia and the alleged acts of racketeering. In fact, in *United States v. Turkette*, 452 U.S. 576 (1981), the Supreme Court essentially rejected such an argument, holding that RICO applies to wholly illegitimate enterprises.

At the very least, the distinction is presently too subjective to possess any predictable meaning. For instance, Wagh did not allege that Citibank cardholders never voluntarily contracted to use Metris' services or that Metris did not provide value in exchange for the fees it received. Wagh simply alleged that Metris caused Citibank to enroll himself (and other card holders) even though he had not consented to enrollment. To the extent Citibank advertised Metris' services to all cardholders and cardholders voluntarily enrolled in Metris' program and received its services, not only did the Citibank / Metris Enterprise engage in activities distinct from the alleged pattern of racketeering activity but it engaged in wholly legitimate activities distinct from the pattern of racketeering. Proof that the enterprise conducts lawful activity will often serve to prove the enterprise is separate from the pattern of racketeering. *Diamonds Plus, Inc. v. Kolber*, 960 F.2d 765, 770 n.5 (8th Cir. 1992). Given its subjective nature, the racketeering activity / enterprise distinction can result in seemingly inconsistent applications. *Compare id. with McDonough v. National Home Ins. Co.*, 108 F.3d 174, 177 (8th Cir. 1997). The courts need to fashion more objective standards to govern the distinction's application.