PARTIAL OPINION (EDITTED BY RICOACT.COM LLC)

943 F.3d 328
United States Court of Appeals, Seventh Circuit.

Steven MENZIES, Plaintiff-Appellant,
v.
SEYFARTH SHAW LLP, an Illinois limited liability partnership, et al., Defendants-Appellees.

No. 18-3232
|
Argued May 22, 2019
|
Decided November 12, 2019
|
Rehearing and Rehearing En Banc Denied December 12, 2019*

Opinion

Scudder, Circuit Judge.

Insurance executive Steven Menzies sold over $64 million in his company's stock but did not report any capital gains on his 2006 federal income tax return. He alleges that his underpayment of capital gains taxes (and the related penalties and interest subsequently imposed by the Internal Revenue Service) was because of a fraudulent tax shelter peddled to him and others by a lawyer, law firm, and two financial services firms. Menzies advanced this contention in claims he brought under the Racketeer Influenced and Corrupt Organizations Act or RICO and Illinois law. The district court dismissed all claims.

Menzies's RICO claim falls short on the statute's pattern-of-racketeering element. Courts have labored mightily to articulate what the pattern element requires, and Menzies's claim presents a close question. In the end, we believe Menzies failed to plead not only the particulars of how the defendants marketed the same or a similar tax shelter to other taxpayers, but also facts to support a finding that the alleged racketeering activity would continue. To conclude otherwise would allow an ordinary (albeit grave) claim of fraud to advance in the name of RICO—an outcome we have time and again cautioned should not occur. In so holding, we in no way question whether a fraudulent tax shelter scheme can violate RICO. The shortcoming here is one of pleading alone, and it occurred after the district court authorized discovery to allow Menzies to develop his claims.

As for Menzies's state law claims, we hold that an Illinois statute bars as untimely the claims advanced against the lawyer and law firm defendants. The claims against the two remaining financial services defendants can proceed, however.

So we affirm in part, reverse in part, and remand.

I

The original and amended complaints supply the operative facts on a motion to dismiss. On appeal we treat all allegations as true, viewing them in the light most favorable to Steven Menzies. See *Moranski v. Gen. Motors Corp.*, 433 F.3d 537, 539 (7th Cir. 2005).

Menzies is the co-founder and president of an insurance company called Applied Underwriters, Inc. or AUI. In 2002 advisers from Northern Trust approached him to begin a financial planning relationship. In time these advisers pitched Menzies and his colleague and AUI co-founder Sydney Ferenc on a tax planning strategy (dubbed the Euram Oak Strategy) to shield capital gains on major stock sales from federal tax liability. Not knowing the strategy reflected what the IRS would later deem an abusive tax shelter, Menzies agreed to go along with the scheme. He conducted a series of transactions that, through the substitution of various assets and the operation of multiple trusts, created an artificial tax loss used to offset the capital gains he realized upon later selling his AUI stock.

Northern Trust worked with others in marketing and implementing the strategy. Christiana Bank, for example, served as trustee for some of Menzies's trusts while tax attorney Graham Taylor and his law firm, Seyfarth Shaw, provided legal advice. Taylor repeatedly assured Menzies and Ferenc of the tax shelter's legality, eventually opining that there was a "greater than 50 percent likelihood that the tax treatment described will be upheld if challenged by the IRS." Taylor stood by his more-likely-than-not opinion even after being indicted in 2005 for the commission of unrelated tax fraud—a development he never disclosed to Menzies.

In 2006 Menzies sold his AUI stock to Berkshire Hathaway for over $64 million. Nowhere in his 2006 federal income tax return did Menzies report the sale or any related capital gains. Nor did Christiana Bank, which filed tax returns on behalf of Menzies's trusts, report any taxable income from the stock sale. When the IRS learned of these developments, it commenced what became a three-year audit and found that the primary purpose of the

PARTIAL OPINION (EDITTED BY RICOACT.COM LLC)

Euram Oak Strategy was tax evasion. Facing large fines and potential adverse legal action, Menzies agreed in October 2013 to settle with the IRS, paying over $10 million in back taxes, penalties, and interest.

In April 2015 Menzies filed suit in the Northern District of Illinois, advancing a civil RICO claim and various Illinois law claims against Taylor, Seyfarth Shaw, Northern Trust, and Christiana Bank. The district court granted the defendants' motion to dismiss, but from there twice allowed Menzies to amend his complaint. Indeed, the district court afforded Menzies a full year of discovery to develop facts to support renewed pleading of the RICO claim that appeared in his second amended complaint in August 2017. On the defendants' motion, the district court dismissed that complaint for failure to state any claim. Menzies now appeals.

II

A. The RICO Bar for Actionable Securities Fraud

Before addressing the district court's dismissal of Menzies's RICO claim, we confront a threshold issue pressed by the defendants—whether an amendment to the RICO statute added by the Private Securities Litigation Reform Act of 1995 or PSLRA precluded Menzies from bringing a RICO claim in the first instance. We agree with the district court that the bar now embodied in 18 U.S.C. § 1964(c) did not prevent Menzies from pursuing a RICO claim on the facts alleged in his complaint.

In enacting the PSLRA, Congress did more than seek to curb abusive practices in securities class actions by, for example, imposing a heightened pleading standard, requiring a class representative to be the most adequate plaintiff, and limiting damages. See *Amgen Inc. v. Connecticut Ret. Plans & Trust Funds*, 568 U.S. 455, 475–76, 133 S.Ct. 1184, 185 L.Ed.2d 308 (2013) (describing the PSLRA). The enactment also amended RICO to prohibit a cause of action based on "any conduct that would have been *actionable as fraud in the purchase or sale of securities*." 18 U.S.C. § 1964(c) (emphasis added).

Upon reviewing the allegations in Menzies's original complaint, the district court denied the defendants' motion to dismiss the RICO claim based on the bar in § 1964(c). The district court started with the observation that "nothing about the sale of his AUI stock itself was fraudulent." *Menzies v. Seyfarth Shaw LLP*, 197 F. Supp. 3d 1076, 1116 (N.D. Ill. 2016) ("*Menzies I*"). "By selling Plaintiff a bogus tax shelter plan," the court reasoned, "[d]efendants were attempting to hide the resulting income from Plaintiff's sale of stock from the IRS," and "[i]n both form and substance" this was a "case about tax shelter fraud, not securities fraud." *Id.*

The defendants urge us to reverse, contending that the RICO bar applies because the whole point of the Euram Oak Strategy was for Menzies to avoid realizing taxable gains from a stock sale. But for the stock sale, the tax shelter meant nothing, thereby easily satisfying, as the defendants see it, the requirement for the alleged fraud to be "in connection with" the sale of a security and thus actionable as securities fraud under section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5.

We see the analysis as more difficult. By its terms, the bar in § 1964(c), as the district court recognized, requires asking whether the fraud Menzies alleged in his complaint would be actionable under the securities laws, in particular under section 10(b) and Rule 10b-5. See *Rezner v. Bayerische Hypo-Und Vereinsbank AG*, 630 F.3d 866, 871 (9th Cir. 2010) (assessing the PSLRA bar and explaining that "[a]ctions for fraud in the purchase or sale of securities are controlled by section 10(b) of the Securities Exchange Act of 1934"); *Bixler v. Foster*, 596 F.3d 751, 759–60 (10th Cir. 2010) (adopting a similar approach); *Affco Investments 2001, LLC v. Proskauer Rose, LLP*, 625 F.3d 185, 189–90 (5th Cir. 2010) (same).

Had he sought to plead a securities fraud claim under those provisions, Menzies would have had to allege a material misrepresentation or omission by a defendant, scienter, a connection between the misrepresentation or omission and the purchase or sale of a security, reliance, economic loss, and loss causation. See *Glickenhaus & Co. v. Household Int'l., Inc.*, 787 F.3d 408, 414 (7th Cir. 2015) (citing *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258, 267, 134 S.Ct. 2398, 189 L.Ed.2d 339 (2014)). The district court got it right in concluding that the allegations in Menzies's original complaint did not amount to actionable securities fraud under federal law.

The Supreme Court supplied substantial direction in *SEC v. Zandford*, 535 U.S. 813, 122 S.Ct. 1899, 153 L.Ed.2d 1 (2002). The SEC brought a civil securities fraud action against a stockbroker who sold his elderly and disabled clients' securities and pocketed the proceeds. See *id.* at 815, 122 S.Ct. 1899. The Court granted review to determine whether the stockbroker's theft, which the SEC alleged also constituted securities fraud, was sufficiently "in connection with" the sale of the clients' securities to fall within section 10(b) and Rule 10b-5. The Court answered yes, explaining that both provisions "should be construed 'not technically and restrictively, but flexibly to effectuate its remedial purposes.' " *Id.* at 819, 122 S.Ct.

PARTIAL OPINION (EDITTED BY RICOACT.COM LLC)

1899 (quoting *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1972)). As a practical pleading matter, the Court continued, that meant a plaintiff need not allege any misrepresentation or omission about a security's value. Nor was it necessary to allege misappropriation or, even more generally, another form of manipulation of a security. What would be enough, the Court held, are allegations where "the scheme to defraud and the sale of securities coincide." *Id.* at 822, 122 S.Ct. 1899.

The SEC's allegations met this standard because the stockbroker defendant, alongside affirmatively misrepresenting how he intended to manage his clients' investments—he "secretly intend[ed] from the very beginning to keep the proceeds"—acted on that intent by engaging in unauthorized securities sales. *Id.* at 824, 122 S.Ct. 1899. This misconduct "deprived [his clients] of any compensation for the sale of their valuable securities." *Id.* at 822, 122 S.Ct. 1899. The "securities transactions and breaches of fiduciary duty coincide[d]," the Court explained, because the "[clients'] securities did not have value for the [stockbroker] apart from their use in a securities transaction and the fraud was not complete before the sale of securities occurred." *Id.* at 824–25, 122 S.Ct. 1899. Put another way, the SEC's allegations left no daylight between the alleged fraud and the securities sale.

Measured by these *Zandford* standards, Menzies's allegations do not satisfy the "in connection with" requirement for an actionable claim under section 10(b) or Rule 10b-5. Start with the alleged fraud itself. Menzies's complaint focused not on the AUI stock sale, but instead on its tax consequences. He alleged that the defendants marketed a tax shelter that they knew was abusive—that would conceal capital gains from the U.S. Treasury—and caused him to incur not just unexpected taxes and related interest and penalties but also substantial professional fees. Yes, this may be enough to show that but for following the defendants' advice and selling his AUI stock he would not have incurred the taxes and related interest and penalties. Yet we know that such "but for" allegations do not satisfy section 10(b) under the teachings of *Zandford*. See *Ray v. Citigroup Global Mkts., Inc.*, 482 F.3d 991, 995 (7th Cir. 2007) (explaining that "[i]t is not sufficient [under section 10(b) and Rule 10b-5] for an investor to allege only that it would not have invested but for the fraud" and instead the investor must go further and "allege that, but for the circumstances that the fraud concealed, the investment ... would not have lost its value") (quoting *Caremark, Inc. v. Coram Healthcare Corp.*, 113 F.3d 645, 648–49 (7th Cir. 1997)).

If Menzies had tried to bring a securities fraud claim, he would have had to close this pleading gap. His complaint would have had to tether more directly the fraud to the stock sale by including allegations that went beyond any "but for" link and allowed a finding that the defendants' misrepresentations more closely coincided with Menzies's sale of his AUI stock. Menzies, in short, would have needed to plead facts demonstrating that he incurred his alleged losses as a more direct consequence of misrepresentations that closely touched the stock sale itself and not just its tax consequences. That the purpose of the tax shelter aimed to maximize the profits that Menzies realized from his stock sale cannot itself bridge this gap. See *Ouwinga v. Benistar 419 Plan Servs., Inc.*, 694 F.3d 783, 791 (6th Cir. 2012) (affirming a district court's conclusion that the RICO bar did not apply because the plaintiffs' "fraud claim relates only to the tax consequences of the Benistar Plan, and it is merely incidental that the [insurance] policies happen to be securities"); *Rezner*, 630 F.3d at 872 (concluding the RICO bar did not apply where, in a tax shelter fraud, "the securities were merely a happenstance cog in the scheme").

We can come at the analysis another way. No aspect of the complaint challenged any term or condition on which Menzies sold his AUI shares to Berkshire Hathaway. The complaint all but says every aspect of the stock sale itself was entirely lawful. Even more generally, no portion of the complaint alleged that any defendant engaged in an irregularity that tainted or affected the stock-sale transaction, including, for example, by influencing the sales price or somehow causing the proceeds to be mishandled. Every indication is that Menzies received every last dollar he expected from the sale. The fraud Menzies alleged is at least one step removed—focused not on the sale of the AUI stock but on how and why he charted a particular course in his treatment of the sale for federal tax purposes and the losses he sustained by doing so.

Do not read us to say that Menzies failed to allege fraud. He plainly did when considered through the prism of common law standards. What we cannot say, though, is that—for purposes of applying the RICO bar in § 1964(c)—Menzies's allegations amounted to actionable securities fraud under the standards the Supreme Court has told us are required by section 10(b) and Rule 10b-5.

While not aligning with the defendants' view of the law, our holding does seem on all fours with what we see and do not see in the securities fraud case law. Our research, limited though it is to reported decisions, reveals no meaningful number of section 10(b) and Rule 10b-5 private federal securities fraud claims brought to

PARTIAL OPINION (EDITTED BY RICOACT.COM LLC)

challenge abusive tax shelters. Nor do we see an indication that the SEC has brought many enforcement proceedings alleging securities fraud to combat abusive tax shelters. None of this suggests that fraud perpetrated as part of a scheme to evade taxes can never be actionable under section 10(b). Our point is limited only to the observation that the federal reporters do not contain many examples of such actions, whether by private parties or the SEC. And perhaps that reality owes itself, at least in part, to the demanding requirements for pleading a federal securities law claim.

Unable to conclude that Menzies's allegations of fraud would be actionable under section 10(b) or Rule 10b-5, we turn, as did the district court, to his civil RICO claim.

B. Civil RICO Claims and the Pattern Element

Enacted in response to long-term criminal activity, including, of course, acts of organized crime, RICO provides a civil cause of action for private plaintiffs and authorizes substantial remedies, including the availability of treble damages and attorneys' fees. See 18 U.S.C. § 1964(c). Establishing a RICO violation requires proof by a preponderance of the evidence of "(1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity." *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 496–97, 105 S.Ct. 3275, 87 L.Ed.2d 346 (1985) (interpreting § 1964(c)). It follows that a plaintiff must plead these elements to state a claim. Congress defined a "pattern of racketeering activity" to require "at least two acts of racketeering activity" within a ten-year period. 18 U.S.C. § 1961(5).

Satisfying the pattern element is no easy feat and its precise requirements have bedeviled courts. See *Jennings v. Auto Meter Prod., Inc.*, 495 F.3d 466, 472 (7th Cir. 2007) (emphasizing that "courts carefully scrutinize the pattern requirement"); *J.D. Marshall Int'l, Inc. v. Redstart, Inc.*, 935 F.2d 815, 820 (7th Cir. 1991) ("Satisfying the pattern requirements—that there be continuity and relationship among the predicate acts—is not easy in practice.").

The Supreme Court has considered the issue at least twice, and our case law shows many efforts to articulate what a plaintiff must plead to establish a pattern of racketeering activity. See, *e.g.*, *Sedima*, 473 U.S. at 496, 105 S.Ct. 3275; *H.J., Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 237–38, 109 S.Ct. 2893, 106 L.Ed.2d 195 (1989); *Vicom, Inc. v. Harbridge Merchant Servs., Inc.*, 20 F.3d 771, 779–80 (7th Cir. 1994); *McDonald v. Schencker*, 18 F.3d 491, 497 (7th Cir. 1994). Over these many cases the law has landed on a pleading and proof requirement designed "to forestall RICO's use against isolated or sporadic criminal activity, and to prevent RICO from becoming a surrogate for garden-variety fraud actions properly brought under state law." *Midwest Grinding Co., Inc. v. Spitz*, 976 F.2d 1016, 1022 (7th Cir. 1992) (citing *H.J., Inc.*, 492 U.S. at 240–41, 109 S.Ct. 2893).

[4]To plead a pattern of racketeering activity, "a plaintiff must demonstrate a relationship between the predicate acts as well as a threat of continuing activity"—a standard known as the "continuity plus relationship" test. *DeGuelle v. Camilli*, 664 F.3d 192, 199 (7th Cir. 2011). The Supreme Court announced this test in *H.J., Inc.* and made plain that the relationship prong is satisfied by acts of criminal conduct close in time and character, undertaken for similar purposes, or involving the same or similar victims, participants, or means of commission. See 492 U.S. at 240, 109 S.Ct. 2893. The relatedness of the predicate acts often does not yield much disagreement, and much more often the focus is on the continuity prong of the test. See *Vicom*, 20 F.3d at 780.

[5]Just so here: the battleground in this appeal is whether Menzies adequately pleaded the continuity dimension of the continuity-plus-relationship test. Doing so requires "(1) demonstrating a closed-ended series of conduct that existed for such an extended period of time that a threat of future harm is implicit, or (2) an open-ended series of conduct that, while short-lived, shows clear signs of threatening to continue into the future." *Roger Whitmore's Auto Servs., Inc. v. Lake County, Ill.*, 424 F.3d 659, 673 (7th Cir. 2005).

[6]Do not let the labels create confusion. The big picture question is whether Menzies adequately alleged that the challenged conduct occurred and went on long enough and with enough of a relationship with itself to constitute a pattern. Answering that question is aided by focusing on two, more particular, inquiries. One of those inquiries—designed to ascertain the presence of a so-called "closed-ended" series of misconduct—asks whether there were enough predicate acts over a finite time to support a conclusion that the criminal behavior would continue. See *Vicom*, 20 F.3d at 779–80. The focus, therefore, is on "the number and variety of predicate acts and the length of time over which they were committed, the number of victims, the presence of separate schemes and the occurrence of distinct injuries." *Id.* at 780 (quoting *Morgan v. Bank of Waukegan*, 804 F.2d 970, 975 (7th Cir. 1986)).

[7] [8]The alternative continuity inquiry—applicable to an "open-ended" series of misconduct—focuses not on what acts occurred in the past but on whether a concrete threat

PARTIAL OPINION (EDITTED BY RICOACT.COM LLC)

remains for the conduct to continue moving forward. See *id.* at 782. This can be done by showing that a defendant's actions pose a specific threat of repetition; that the predicate acts form part of the defendant's ongoing and regular way of doing business; or that the defendant operates a long-term association for criminal purposes. See *Empress Casino Joliet Corp. v. Balmoral Racing Club, Inc.*, 831 F.3d 815, 828 (7th Cir. 2016). On these fronts, it is not enough to base an open-ended continuity theory on just one prior predicate act and an otherwise unsupported assertion that criminal activity will continue into the future. See *Gamboa v. Velez*, 457 F.3d 703, 709 (7th Cir. 2006) (explaining that when "a complaint explicitly presents a distinct and non-recurring scheme with a built-in termination point and provides no indication that the perpetrators have engaged or will engage in similar misconduct, the complaint does not sufficiently allege continuity").

Added complexity enters where, as here, a plaintiff seeks to plead RICO's pattern element through predicate acts of mail or wire fraud. When that occurs the heightened pleading requirements of Fed. R. Civ. P. 9(b) apply and require a plaintiff to do more than allege fraud generally. See *Jepson v. Makita Corp.*, 34 F.3d 1321, 1327 (7th Cir. 1994) ("Of course, Rule 9(b) applies to allegations of mail and wire fraud and by extension to RICO claims that rest on predicate acts of mail and wire fraud."). Rule 9(b) requires a plaintiff to provide "precision and some measure of substantiation" to each fraud allegation. *United States ex rel. Presser v. Acacia Mental Health Clinic, LLC*, 836 F.3d 770, 776 (7th Cir. 2016). Put more simply, a plaintiff must plead the "who, what, when, where, and how" of the alleged fraud. *Vanzant v. Hill's Pet Nutrition, Inc.*, 934 F.3d 730, 738 (7th Cir. 2019).

Given these heightened pleading standards and Congress's insistence that a RICO claim entail a clear pattern of racketeering activity, we have cautioned that "we do not look favorably on many instances of mail and wire fraud to form a pattern." *Midwest Grinding*, 976 F.2d at 1024–25 (quoting *Hartz v. Friedman*, 919 F.2d 469, 473 (7th Cir. 1990)); see also *Jennings*, 495 F.3d at 475 (explaining that this court "repeatedly reject[s] RICO claims that rely so heavily on mail and wire fraud allegations to establish a pattern"). We can leave for another day a more fulsome articulation of the interrelationship of RICO's pattern requirement and mail and wire fraud as predicate acts. Our focus here is whether Menzies, within the four corners of his complaint, alleged with sufficient particularity the acts of mail and wire fraud he believes demonstrate a pattern of racketeering activity.

C. Menzies's Allegations of Racketeering Activity

In his second amended complaint, Menzies detailed chapter and verse the fraud the defendants allegedly perpetrated on him. He told of the defendants approaching and pitching him the tax benefits of the Euram Oak Strategy. Reassured multiple times of the shelter's legality, Menzies relied on the defendants' representations, executed the strategy's component steps through transactions with trusts and the like, and ultimately sold his AUI stock for over $64 million to Berkshire Hathaway. Again relying on the defendants' assurances, he then filed his 2006 tax return without reporting his AUI stock sale as a taxable event.

Menzies sought to plead RICO's pattern element by including allegations that the defendants marketed the identical or a substantially-similar tax shelter to three others—his business partner and co-founder of AUI, Sydney Ferenc, and two other investors, one in North Carolina and another in Arizona.

Menzies alleged that Northern Trust contacted him and Ferenc at the same time to develop a financial advisory relationship. See SAC ¶¶ 25, 42, and 43. The complaint provides substantial detail on the defendants' interactions with Ferenc, including the dates and content of phone calls, emails, and meetings geared toward selling and advancing the scheme. See SAC ¶¶ 58, 62, 63, 76, 81, 86, 88, and 115. By way of example, consider these two factual allegations detailing the timing and substance of Ferenc's interactions with attorney Graham Taylor:

> • "On September 30, 2003, Taylor provided Ferenc with an outline of the pre-arranged steps of the Euram Oak Strategy via email, assuring Ferenc that the strategy was legitimate tax planning." SAC ¶ 81.
>
> • "On or about August 5, 2004, August 11, 2004 and August 18, 2004, Taylor sent Ferenc a revised version of the tax opinion letter via e-mail assuring Ferenc (and Menzies) that the Euram Oak Strategy was legitimate tax planning." SAC ¶ 115.

From there Menzies alleged that Ferenc ultimately "entered into a transaction substantially similar" to the one undertaken by Menzies, including by receiving a loan from Euram Bank, establishing a grantor trust, and maneuvering various assets in anticipation of a major stock sale—all in accordance with the instructions supplied by Taylor and others. SAC ¶ 91.

While the complaint clearly alleges the defendants marketed the same fraudulent tax shelter to Ferenc, Menzies stopped short of alleging whether Ferenc followed through with his sale of AUI stock and incurred

PARTIAL OPINION (EDITTED BY RICOACT.COM LLC)

substantial capital gains tax liability and related penalties and interest as a result of subsequent IRS scrutiny. The absence of such allegations in no way meant that Menzies failed to plead a predicate act of mail and wire fraud involving Ferenc, however. See *United States v. Koen*, 982 F.2d 1101, 1106 (7th Cir. 1992) (explaining that mail fraud under 18 U.S.C. § 1341 requires not actual and successful deception but only "(1) a scheme to defraud and (2) use of the mail for the purpose of executing, or attempting to execute, the scheme to defraud").

Menzies further alleged an Arizona investor fell victim to the defendants' scheme. The second amended complaint alleged that the Arizona investor received legal opinions from Taylor and Seyfarth Shaw regarding the Euram Oak Strategy sometime in 2004. From there, though, the complaint says little more, alleging only that it is "reasonable to assume that any such opinion letter asserts the legality of the [Euram Oak] Strategy." SAC ¶ 162. On "information and belief," the complaint then alleges that the Arizona investor incurred unspecified damages from the tax deficiency that resulted from the scheme, penalties and interest, professional and attorneys' fees, and the lost opportunity to invest in a legitimate tax planning vehicle. See SAC ¶ 165.

In much the same way, Menzies included similar allegations of fraud against a North Carolina investor. According to the complaint, the defendants approached this investor not with the Euram Oak Strategy but with a different abusive tax shelter of the same nature called the Euram Rowan Strategy. See SAC ¶¶ 166, 167. With the exception of Northern Trust, the other defendants pushed the Euram Rowan Strategy, which "involved a series of integrated, pre-arranged, and scripted steps designed to provide a taxpayer who had significant ordinary or capital gain with a non-economic ordinary or capital loss." SAC ¶ 167. Here too, however, the second amended complaint adds few details. In 2003 the North Carolina investor received legal opinions from Taylor and Seyfarth Shaw—leaving Menzies to allege that "it is reasonable to assume that any such opinion letter asserted the legality of the transaction." SAC ¶ 177. From there the complaint alleges that the North Carolina investor, as a result of the scheme, owed a tax deficiency of $17.5 million to the IRS, along with nearly $1 million in penalties. SAC ¶ 180.

The second amended complaint also included broad allegations of future harm. On this score, Menzies alleged that "[t]here is a threat of continued racketeering activity in that Defendants' predicate acts of mail and wire fraud were part of their regular way of conducting business." SAC ¶ 183. This future threat, the complaint added, is clear from the "manner in which the Euram products were presented as products, with a preexisting team that could execute and support the tax shelter for other taxpayers and from the regular manner in which this enterprise did business with Menzies, Ferenc, [the Arizona and North Carolina investors] and other investors in the fraudulent Euram strategies." SAC ¶ 184.

D. The District Court's Opinion

The district court dismissed Menzies's RICO claim for failing to adequately plead a pattern of racketeering under either the closed- or open-ended theories of continuity. See *Menzies v. Seyfarth Shaw LLP*, No. 15C3403, 2018 WL 4538726 (N.D. Ill. Sept. 21, 2018) ("*Menzies II*").

As to the closed-ended approach, the court focused on Menzies's allegations of fraud against Ferenc and the North Carolina and Arizona investors. Relying on *Emery v. American Gen. Fin., Inc.*, 134 F.3d 1321 (7th Cir. 1998), the district judge assessed whether these additional allegations showed the other victims were "actually deceived" by the defendants' communications regarding the scheme. *Menzies II*, 2018 WL 4538726, at *4. The district court read Menzies's complaint to lack particularity about statements any defendant made to the Arizona investor about the Euram Oak Tax Strategy and, even more specifically, whether any misrepresentation led to the investor being deceived and suffering adverse tax consequences. The same deficiency plagued Menzies's allegations about the North Carolina investor, as the complaint was silent as to whether and how the defendants marketed the Euram Rowan Strategy in a way that resulted in actual deception and related losses. As to Ferenc, the district court emphasized that Menzies "does not allege that Ferenc was deceived, how he was deceived, or even that he suffered any injury in the way of IRS penalties or disallowances." *Id.* at *5.

In summing these pleading shortcomings, the district court reasoned that they were "particularly problematic in a case, like this one, where the purported victims knowingly entered into tax shelters, which by their nature are designed to avoid taxes." *Id.* The district court was unwilling to afford Menzies additional leeway to develop a potential RICO claim because he had already filed two prior complaints and had over a year to conduct discovery before filing his second amended complaint. See *id.* at *9.

Turning to whether that complaint adequately alleged an open-ended theory of continuity, the district court likewise concluded that Menzies came up short. The court emphasized that the complaint identified no specific threat of the tax avoidance strategy repeating, in no small part because the attorney responsible for orchestrating the

PARTIAL OPINION (EDITTED BY RICOACT.COM LLC)

scheme, Graham Taylor, had been indicted for tax fraud in 2005 and convicted in 2008. See *id.* at *6. These facts, without some alternative explanation from Menzies, undermined any meaningful possibility that Graham and the other defendants would continue to perpetuate the alleged fraud. See *id.* What is more, the district court was unwilling—without supporting facts appearing somewhere in Menzies's complaint—to permit an inference that the alleged fraud reflected any of the institutional defendants' regular way of doing business. On Menzies's pleading, the district court saw any such conclusion as reflecting rank speculation. See *id*. at *7.

E. Menzies's Insufficient Pleading of the Pattern Element

We agree with the district court that Menzies failed to allege a pattern of racketeering based on mail and wire fraud predicates. The proper analysis begins by returning to Menzies's second amended complaint, and it is there that the details—or lack thereof—matter. This is so because of the combined demands of RICO's pattern element and Rule 9(b)'s particularity mandate.

Menzies is right that he pleaded enough to support a conclusion that what Sydney Ferenc experienced qualifies as a predicate act of racketeering activity for pattern purposes. The second amended complaint is replete with details describing how the defendants used phone calls, e-mails, and meetings to assure Ferenc that the Euram Oak Strategy reflected lawful tax minimization. Those allegations speak directly to the nature and substance of the mail and wire fraud allegedly perpetrated on Ferenc and are advanced with the specificity necessary to clear Rule 9(b)'s particularity hurdle. And this is so even though Menzies's complaint does not allege that Ferenc went through with AUI stock sales and the Euram Oak Strategy tax treatment. See *Koen*, 982 F.2d at 1107.

Menzies's complaint is night and day different, though, when it comes to the allegations regarding the Arizona and North Carolina investors. The details of the defendants' interactions with both investors are few and far between. The second amended complaint says little more than that one or more of the defendants targeted these investors and sought to sell them either the Euram Oak or Rowan Strategies. Nowhere, though, does the complaint spell out the specifics of any defendant's communications with either investor and instead resorts to saying "on information and belief" that each of the two investors received an opinion letter from defendant Graham Taylor and furthermore that "it is reasonable to assume that any such opinion letter asserted the legality of the transaction." SAC ¶¶ 162, 177.

These allegations meet neither Rule 9(b)'s particularity requirement nor the demands of our RICO case law. In *Emery,* we emphasized that RICO's pattern element requires more than a plaintiff pointing to others and saying, on information and belief, that those persons received mailings about an allegedly fraudulent loan scheme. See 134 F.3d at 1322. The plaintiff needed to come forward, not with general statements about what others may have received, but with particular allegations detailing the content of the communications with others allegedly defrauded by the defendant's conduct. See *id.* at 1323. Without those alleged facts there was no way to conclude that the plaintiff had advanced with particularity the predicate acts of mail or wire fraud against anyone other than himself. The complaint, in short, failed to plead the requisite pattern of racketeering activity. See *id.*

We see Menzies's second amended complaint in much the same way. He did not plead enough about what transpired with the Arizona and North Carolina investors for us to know what any defendant represented, misrepresented, or omitted. *Emery* teaches that the pleading bar requires more than positing that he believes these two investors received similar opinion letters from Graham Taylor. Resorting to that level of generality sidesteps what Rule 9(b) requires. What Menzies needed to do—drawing perhaps on what he learned in the year of discovery afforded by the district court—was allege at least some particulars about the precise communications with each investor. See *Katz v. Household Int'l, Inc.*, 91 F.3d 1036, 1040 (7th Cir. 1996) (explaining the demands of Rule 9(b) are relaxed only if discovery is unavailable to a plaintiff). Without such allegations, we have no way to determine whether multiple predicate acts of mail or wire fraud occurred in a manner that satisfies RICO's pattern requirement.

Without predicate acts of fraud covering the Arizona and North Carolina investors, Menzies is left only with the allegations of what he and Sydney Ferenc experienced with the defendants. That falls short of pleading a pattern of racketeering under the closed-ended approach to the continuity-plus-relationship test that the Supreme Court announced in *H.J., Inc*. We need to look at the number and variety of predicate acts, the length of time over which they were committed, the number of victims, the presence of separate schemes, and the occurrence of distinct injuries. *Vicom*, 20 F.3d at 780; see also *Roger Whitmore's Auto Servs.*, 424 F.3d at 673 (explaining that, in this analysis, "[n]o one factor is dispositive"). In doing so, we keep foremost in mind a "natural and commonsense approach to RICO's pattern element," which requires enforcing "a more stringent requirement than proof simply of two predicates, but also envisioning

PARTIAL OPINION (EDITTED BY RICOACT.COM LLC)

a concept of sufficient breadth that it might encompass multiple predicates within a single scheme that were related and that amount to, or threatened the likelihood of, continued criminal activity." *H.J., Inc.*, 492 U.S. at 237, 109 S.Ct. 2893.

But here we only have two individuals (Menzies and Ferenc)—two business partners and indeed co-founders of AUI—who allegedly fell victim to the same fraudulent scheme (the Euram Oak Strategy) at the same time. While the scheme lasted from 2003 to 2006, the complaint alleges only that Menzies went through with the strategy and suffered adverse tax consequences. The second amended complaint says not a word about whether Ferenc followed through on the strategy or suffered financial harm of any kind. Given Menzies's close business relationship with Ferenc, the absence of particular factual allegations about how and to what degree Ferenc was defrauded is noteworthy.

On the whole, though, Menzies alleged enough with respect to Ferenc to establish a predicate act of mail or wire fraud. And with those allegations he advanced, in total, at least two such predicates (against himself and Ferenc). But RICO's pattern element is not just quantitative; it includes qualitative components designed to ascertain the presence of a pattern of racketeering activity. And it is on this precise point—whether Menzies alleged enough, quantitatively and qualitatively, to show a qualifying pattern of racketeering activity—that we determine his pleading was deficient.

To conclude that Menzies has failed to plead closed-ended continuity is not to say that he has failed to plead fraud. He clearly has and indeed he uses those precise allegations of fraud as the basis for his state law claims against the defendants. But what we are not permitted to do is allow a plaintiff to shoehorn a state-law fraud claim into a civil RICO claim. See *Jennings*, 495 F.3d at 472. It is the statute's pattern element that separates the viable RICO wheat from the common-law chaff, and, despite substantial effort, Menzies has come up short.

[14]Our analysis of the open-ended theory of a pattern of racketeering is more straightforward. Only a few lines of the second amended complaint even hint at any threat of continued fraud by the defendants, and even then Menzies presents only conclusory assertions to support those allegations. He urges us to infer a future threat of repetition because the Euram Oak Strategy was developed for marketing to many taxpayers and thus inherently presented a "threat of repetition" capable of defrauding others.

[15]But "[a] threat of continuity cannot be found from bald assertions." *Vicom*, 20 F.3d at 783. The law requires us to examine Menzies's complaint for allegations of "predicate acts, [which] by their very nature, pose 'a threat of repetition extending indefinitely into the future,' or 'are part of an ongoing entity's regular way of doing business.' " *McDonald*, 18 F.3d at 497 (quoting *H.J., Inc.*, 492 U.S. at 242, 109 S.Ct. 2893).

What we see is insufficient. Even if we credit Menzies's contention that the development and marketing of the Euram Oak Strategy foretold future offenses, the claim still would fail to measure up to the standard of alleging open-ended continuity. That the tax shelter scheme was, as our dissenting colleague puts it, an "off-the-rack product" capable of distribution to other victims does not alone threaten continuity. We cannot conclude as a legal matter—altogether without regard to what a plaintiff alleges in a complaint—that all fraudulent tax shelters designed for use by multiple taxpayers satisfy open-ended continuity for purposes of RICO's pattern element.

A close look at the complaint shows allegations suggesting that any risk of future fraud was drying up. As the district court highlighted, a grand jury indicted Graham Taylor for tax fraud in 2005, and he was convicted in 2008. With Taylor out of the factual equation it is unclear how Menzies's complaint supports any inference that the alleged scheme would continue. Menzies's complaint is full of indications that the scheme was running its course—reaching its "natural ending point," *Roger Whitmore's Auto Servs.*, 424 F.3d at 674—and was not being shopped to new targets:

> • In 2007, Euram Bank divested from its subsidiary, Pali Capital, which made integral contributions to the implementation of the Euram Oak and Rowan strategies. SAC ¶ 19.
>
> • In 2008, Seyfarth Shaw forced one of Taylor's colleagues who had helped with the opinion letters to resign for himself promoting illegal tax shelters. SAC ¶ 122.
>
> • As early as 2003, Christiana Bank and Euram Bank were conducting internal investigations with the assistance of outside counsel "regarding the possibility that the Euram Oak Strategy might be a reportable transaction to the IRS." SAC ¶ 94.

Nowhere does Menzies counterbalance these allegations with facts suggesting the schemes promoted by the defendants presented any meaningful prospect of continuing. Instead, the thrust of Menzies's complaint

PARTIAL OPINION (EDITTED BY RICOACT.COM LLC)

conveys that the defendants were taking action to move away from the promotion of the fraudulent tax shelters challenged here.

The dissent sees our analysis as falling prey to "hindsight error" by considering these intervening events. Not so. All we have done is reach a conclusion about the sufficiency of Menzies's RICO pleading by assessing the totality of his factual allegations. We cannot stop halfway by, for example, overlooking what Menzies chose to plead about Taylor's indictment and what did (and did not) happen in its wake. The open-ended continuity inquiry requires more than pinpointing a moment in time where it looked like a scheme may entail continuity but then disregarding facts supplied by the plaintiff that point in the opposite direction. What is missing from Menzies's second amended complaint is any factual allegation supporting his conclusion that, following Taylor's arrest and indictment, there existed a threat of the defendants fraudulently marketing the tax shelter into the indefinite future.

Because Menzies did not plead a pattern of racketeering under either an open- or closed-ended theory of continuity, we agree with the district court's dismissal of his RICO claim.

* * *

Therefore, the judgment of the district court is AFFIRMED in part, VACATED in part, and REMANDED for proceedings consistent with this opinion.

Footnotes

* Judge Joel M. Flaum did not participate in the consideration of this matter.