New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
Web address: http://www.law.com/ny
VOLUME 230—NO. 80 WEDNESDAY, OCTOBER 22, 2003

SECOND CIRCUIT REVIEW

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Clarifying the Test for RICO Standing

IN THIS month's column, we examine the U.S. Court of Appeals for the Second Circuit's recent decision in *Baisch v. Gallina*, No. 02-9047, 2003 WL 22255599 (2d Cir. Oct. 2, 2003), in which the court clarified its RICO standing jurisprudence by holding that, when determining whether a plaintiff has standing to assert RICO claims, "it is inappropriate to apply a zone-of-interests test independent of this circuit's proximate cause analysis." *Baisch*, 2003 WL 22255599, at *5. As a result of this ruling, the Second Circuit affirmed in part, and vacated and remanded in part, the decision of the U.S. District Court for the Eastern District of New York, which had granted summary judgment for various defendants.

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Background

Plaintiff Baisch provided "construction services, including extending financing to other construction firms." Id. at *1.

Mr. Baisch alleged that defendants had defrauded him, as well as Nassau County and various unnamed insurance companies, by falsifying construction documents, payroll forms and other documents, and submitting inflated estimates and falsified claim vouchers — necessary to meet various county-imposed auditing, reporting and reimbursement requirements — all comprising a pattern of racketeering activity. Id. Mr. Baisch claimed that defendants Gallina and McKinnon-Doxsee, providers of insurance brokerage services to Raycon Construction Co., "knew that the [owners of Raycon] were engaged in racketeering activity" and actively helped them by, among other things, obtaining insurance policies and performance bonds, providing false certificates of insurance and fraudulently obtained replacement policies and preparing false information used by disability and workers' compensation insurance carriers in audits of Raycon. Id.

Relying on Gallina's misrepresentations regarding Raycon's creditworthiness, Mr. Baisch made a series of commercial loans to Raycon, which he now claims were used to support its scheme to obtain fraudulent payments and reimbursements from Nassau County. Mr. Baisch and Raycon also entered into a factoring agreement in 1997, "under which Baisch would loan money to Raycon approximately equal to the amount of Raycon's claim vouchers submitted to Nassau County" for reimbursement. Id. at *1-2. Mr. Baisch claims that Raycon used these loans to "continue their racketeering activities." Id. at *2. In addition, "some of the vouchers were never even submitted to Nassau County, leading Baisch to provide loans that, under the terms of the factoring agreement, could not be repaid," causing over $300,000 in losses for Mr. Baisch. Id.

After employing the "zone-of-interests" test articulated by the Second Circuit in *Abrahams v. Young & Rubicam, Inc.*, 79 F3d 234 (2d Cir. 1996), the Eastern District granted summary judgment to defendants Gallina and the McKinnon-Doxsee Insurance Agency, finding that Mr. Baisch lacked standing to bring his claims under §§1962(c) and (d) of the civil RICO statute. The lower court found that, "the factoring agreement and the relationship between Baisch [and the defendants-appellees] was too distinct from the overall County scheme to be part of it for the purpose of RICO liability," and that, "[t]here [was] no evidence to suggest that the intent of the enterprise — as opposed to the factoring agreement — was to defraud Baisch." *Baisch*, 2003 WL 22255599, at *3 (citation omitted). Consequently, the court determined that Mr. Baisch lacked standing on two independent grounds: (1) Mr. Baisch was not "the target of the racketeering enterprise," (quoting *Abrahams*, 79 F3d at 238); and furthermore, (2) Mr. Baisch's injury did not "flow from the harms that the predicate acts … were intended to cause and

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the laws against them were intended to prevent." Id.

The Appeal

On appeal, Mr. Baisch argued that he had standing to assert claims under both §§1962(c) and (d) of the civil RICO statute. Under §1962(c), it is "unlawful for any person employed by or associated with any enterprise engaged in … interstate or foreign commerce [] to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity …."; the statute further provides that "any person injured in his business or property by reason of a violation of section 1962 … shall recover threefold the damages he sustains." 18 USC §1962(c). Section 1962(d) merely makes it "unlawful for any person to conspire to violate" subsection (c). 18 USC §1962(d).

The Second Circuit agreed. In a decision written by Chief Judge John M. Walker Jr., as well as on behalf of Judges Guido Calabresi and Dennis G. Jacobs, the circuit vacated the lower court's grant of summary judgment and ordered that the case be remanded for further proceedings consistent with the holding that "it is inappropriate to apply a zone-of-interests test independent of this circuit's proximate cause analysis." *Baisch*, 2003 WL 22255599, at *5.

In analyzing the standing issue, the Second Circuit first emphasized that "[t]he Supreme Court has advised that 'RICO is to be read broadly [and] liberally construed to effectuate its remedial purposes.' " Id. at *4 (citing *Sedima, S.P.R.L. v. Imrex Co.*, 473 US 479, 497-98 (1985)). Relying on its prior decision in *Lerner v. Fleet Bank, N.A.*, 318 F3d 113, 120-24 (2d Cir. 2003), the Second Circuit held that to demonstrate standing, a plaintiff must plead at a minimum: (1) defendant's violation of 18 USC §1962(c); (2) an injury to the plaintiff's business or property; and (3) causation of the injury by the defendant's violation. The court explained that this third prong is satisfied if the defendant's "injurious conduct is both the factual and the proximate cause of the injury alleged." Id. (citing *Lerner*, 318 F3d at 120).

The Second Circuit explained, however, that it has incorporated into its proximate cause analysis for RICO standing, the language of the zone-of-interests test. The zone-of-interests test, often referred to as "statutory standing" under RICO, seeks to determine whether, apart from the directness of the injury, the plaintiff is within the class of persons the statute sought to protect and whether the harm done was one that the statute was meant to prevent. The court made it clear in *Baisch* that it is inappropriate to apply a zone-of-interests test independent of the proximate cause analysis.

Accordingly, the court enunciated a two-part test for proximate causation, under which the plaintiff first must establish that his or her injury was " 'proximately caused by a pattern of racketeering activity violating [18 USC §] 1962 or by individual RICO predicate acts' " — meaning, "a plaintiff does not have standing if he suffered an injury that was indirectly (and, hence, not proximately) caused by the racketeering activity or RICO predicate acts." Id. at *5 (citing *Lerner*, 318 F3d at 122-23). This is the case "even though the injury was proximately caused by some non-RICO violations committed by the defendants." Id.

Second, to demonstrate proximate causation, "the plaintiff must have suffered a direct injury that was foreseeable." Id. at *6. Under this theory of foreseeability, a defendant is liable "only to those with respect to whom his acts were 'a substantial factor in the sequence of responsible causation,' and whose injury was 'reasonably foreseeable or anticipated as a natural consequence.' " Id. (citing *Lerner*, 318 F3d at 123).

Proximate Causation

Applying its proximate causation analysis, the court found that "[Mr.]Baisch's injury was directly caused by the … fraudulent factoring agreement" and that "[t]he mail frauds against [Mr.] Baisch through the factoring agreement directly promoted the fraud against Nassau County, and the fraud against Nassau County was the basis for the fraud against Baisch that led to his injury." Id. Chief Judge Walker thus concluded that "[t]he frauds against Baisch and those against Nassau County were not just linked; they were intertwined as coordinated parts of one racketeering enterprise, and they formed a 'pattern' of racketeering." Id. (citation omitted).

The court also found, contrary to the lower court's analysis, that Mr. Baisch was clearly a target and "intended victim[] of the racketeering enterprise." Id. at *7. Chief Judge Walker explained that "RICO standing extends to all directly injured parties, not just the most directly injured among them," arguably, Nassau County in this instance. Id. Chief Judge Walker could find "[n]o precedent [suggesting] that a racketeering enterprise may have only one 'target,' " or that only a primary target has standing. Id. As the court said, "the defendants specifically targeted Baisch as their victim allegedly by taking his loans under false pretenses and consciously creating a high risk of defaulting on those loans." Id.

Conclusion

The pragmatic impact of *Baisch* may prove to be significant. The Second Circuit has articulated a broader, more inclusive RICO standing requirement that satisfies the statute's remedial purposes and empowers a wider range of potential plaintiffs.

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