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A legal update from Dechert's Mass Torts and Product Liability Group

Courts Take Conflicting Views on Class Certification in Consumer Product RICO Cases

RICO "was created to give the government more power to keep organized mobsters from infiltrating businesses. But today, U.S. attorneys file only a handful of criminal cases each year. Instead, it's evolved into a powerful and controversial tool for suing corporations in civil class action suits."[1] Moreover,

> RICO has become an increasingly common claim in product-related litigation. This strange phenomenon is only one natural outgrowth of the many non-traditional uses that creative plaintiffs' lawyers have found for RICO. The RICO "person" is no longer the hit man, but the corporate entity that manufacturers a product. The "enterprise" is not the crime family but the network of retailers or dealers that sell the manufacturer's product. The manufacturer is "associated" with the network of retailers or dealers by virtue of the dealership and/or agency contracts that give the manufacturer a degree of control over the retailer/dealer's prices, advertising, inventory, and so on. The predicate activity engaged in by the manufacturer is mail and wire fraud, or allegedly fraudulent product advertisements that are distributed through the mail or over the radio and television. To convert a product liability claim into a RICO claim, a plaintiff usually only needs one arguably fraudulent phrase that is repeated in product advertising.[2]

Attempts to achieve class certification in putative consumer products class actions brought under RICO have met with mixed results. Two recent decisions—one from a district court in Massachusetts and one from the Second Circuit—illustrate the divergent approaches courts have taken. In *New England Carpenters Health Benefits Fund v. First Databank, Inc.*, a district court in Massachusetts certified two national classes of pharmaceutical drug purchasers.[3] By contrast, in *McLaughlin v. American Tobacco Co.*, the Second Circuit Court of Appeals reversed and decertified a class of "light" cigarette purchasers.[4] These contrasting approaches illustrate that the forum remains critical to the outcome.

Background

RICO, the Racketeer Influenced and Corrupt Organizations Act, makes it unlawful to conduct or participate in, directly or indirectly, an "enterprise" that engages in a "pattern of

1 Megan Barnett, *A Law of Unintended Consequences: How Did a Racketeering Law Designed to Defang the Mafia Become a Nightmare for Corporate America?*, Portfolio (October 29, 2007) (available at http://www.portfolio.com/news-markets/national-news/portfolio/2007/10/29/RICO-Law-of-Unintended-Consequences#page1).

2 Jeffrey E. Grell, *Exorcising RICO from Product Litigation*, 24 Wm. Mitchell L. Rev. 1089, 1092 (1998).

3 *New England Carpenters Health Benefit Fund v. First Databank, Inc.*, 244 F.R.D. 79 (D.Mass. 2007) ("*Carpenters I*"); *New England Carpenters Health Benefit Fund v. First Databank, Inc.*, No. 05-11148-PBS, 2008 WL 723774 (D.Mass. Mar. 19, 2008) ("*Carpenters II*").

4 *McLaughlin v. American Tobacco Co.*, No. 06-4666-cv, 2008 WL 878627 (2d Cir. Apr. 3, 2007).

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racketeering activity." 18 U.S.C. § 1961(c). A RICO "enterprise" can be "virtually any *de facto* or *de jure* association."[5] A "pattern of racketeering activity" is statutorily defined to "require[] at least two acts of racketeering activity." 18 U.S.C. § 1961(5). Such activity includes mail fraud (18 U.S.C. § 1341), wire fraud (18 U.S.C. § 1343), and a long list of other specifically enumerated "predicate acts." *See* 18 U.S.C. § 1961(1). While RICO is primarily a criminal statute, it provides civil damages—indeed, treble damages—to "any person injured in his business or property by reason of a violation of [the criminal provisions]." 18 U.S.C. § 1964(d).

In *Carpenters*, plaintiffs alleged that the publishers of "average wholesale price" ("AWP") information engaged in a scheme to artificially inflate the AWP for numerous prescription pharmaceuticals, allegedly resulting in higher prices for consumers and third-party payors ("TPPs"), such as insurance companies and smaller Taft-Hartley health and welfare plans. The defendants argued that class certification was inappropriate because individualized issues predominated. For example, TPPs had unique contracts. Some TPP contracts had "heat seeking missiles" that automatically reduced costs if AWP increased. Other contracts had rebates increase as AWP increased. Other TPPs "pushed back" against the price increases by renegotiating their contracts. Because of these variations, the defendants argued, individualized issues of causation and damages would swamp the litigation of common issues. The district court disagreed. Although it "carved out" of the class definition any TPPs that actually renegotiated their contracts after the AWP increase, the court held that as to all of the remaining class members, these contract variations were merely an issue of calculating damages.

In *McLaughlin*, plaintiffs claimed that tobacco companies had fraudulently marketed their "light" cigarettes as healthier than "full-flavor" cigarettes. This was untrue, plaintiffs argued, because "[m]ost smokers who smoke Lights obtain just as much tar and nicotine as they would if they smoked full-flavored cigarettes, principally by 'compensating'—that is, either by inhaling more smoke per cigarette (*e.g.*, by covering ventilation holes, drawing more deeply with each puff, etc.) or by buying more cigarettes. . . ." *McLaughlin*, 2008 WL 878627, at *1. The Second Circuit decertified the class because "under RICO, *each* plaintiff must prove reliance, injury, and damages." *Id.* (emphasis in original). The Second Circuit found that these elements could not be litigated on a class-wide basis—"at least not without causing collateral damage to the fabric of our laws"—because "Rule 23 is not a one-way ratchet, empowering a judge to conform the law to the proof." *Id.*

Rule 23 and the Elements of Civil RICO

Differences between pharmaceutical pricing practices and tobacco marketing alone do not fully explain the disparate results in *Carpenters* and *McLaughlin*. Rather, the courts reached different results because they viewed the interaction between the elements of civil RICO and the standards for class certification differently. The contrasts are so stark that the courts seemed to have been interpreting different statutes.

Reliance

The majority of federal circuits that have considered the issue have held that reliance is a necessary element in a civil RICO claim predicated on mail or wire fraud,[6] but some circuits disagree.[7] The U.S. Supreme Court is currently considering a case that will likely resolve this inter-circuit split. That case, *Bridge v. Phoenix Bond & Indemn. Co.*, was argued before the Supreme Court on April 14 and is likely to be decided by this summer.

In the meantime, the conflicting views on the reliance element were reflected in *Carpenters and McLaughlin*. The word "reliance" does not appear a single time in *Carpenters'* analysis of the RICO claims. Moreover, in its very brief discussion of the consumer class, the court characterizes the class claims as "consumer fraud claims." *Carpenters I*, 244 F.R.D. at 85. This characterization, though only a passing reference, is telling. Most consumer fraud statutes do not require a showing of reliance. The plaintiffs, for example, brought supplemental state law claims under the California False Advertising Statute and Unfair Competition Law, Cal. Bus. & Prof. Code §§ 17500 and 17200, consumer statutes

[5] *Seville Indus. Mach. Corp. v. Southmost Mach. Corp.*, 742 F.2d 786, 789 (3d Cir. 1984).

[6] *See Chisolm v. Transouth Financial Corp.*, 95 F.3d 331, 337 (4th Cir. 1996); *Summit Props. Inc. v. Hoechst Celanese Corp.*, 214 F.3d 556, 560 (5th Cir. 2000); *Brown v. Cassens Transport Co.*, 492 F.3d 640, 643 (6th Cir. 2007); *Appletree Square I, Ltd. P'ship v. W.R. Grace & Co.*, 29 F.3d 1283, 1287 (8th Cir. 1994); *Pelletier v. Zweifel*, 921 F.2d 1465, 1499-1500 (11th Cir. 1991). As set forth in the main text, with *McLaughlin* the Second Circuit joined these courts by imposing a reliance requirement.

[7] *See Systems Management, Inc. v. Loiselle*, 303 F.3d 100, 103-04 (1st Cir. 2002); *Phoenix Bond & Indemn. Co. v. Bridge*, 477 F.3d 928, 932 (7th Cir. 2007).

that do not require proof of reliance. In recasting the *Carpenters* RICO claims as "consumer fraud claims," the court implicitly rejected a reliance requirement.

The opposite was true for the *McLaughlin* court, which stated that "proof of misrepresentation—even widespread and uniform misrepresentation—only satisfies half of the equation; the other half, reliance on the misrepresentation, cannot be the subject of general proof." *McLaughlin*, 2008 WL 878617, at * 4. Thus, a smoker who purchased Lights for some reason other than the belief the cigarettes were healthier, for example, because of a preference of taste or "personal style," did not rely on the alleged misrepresentation. *Id.* That issue can only be litigated on an individual basis. The Second Circuit then rejected the so-called "fraud on the market" theory of reliance, a theory borrowed from securities law which argues that uniform misrepresentations about a consumer product artificially inflate the product's price, thereby creating a presumption of reliance applicable to all class members. The court noted that since the publication of Monograph 13, a 2001 National Cancer Institute publication that "revealed" the supposed Light cigarette "fraud," there has been no "appreciable drop in the demand or price of light cigarettes." *Id.* at *7. Therefore, the court found, the claim that the price was artificially inflated prior to the publication fails as a matter of law.

Injury

The courts also took very different views on RICO's requirement that a plaintiff prove an injury to "business or property." 18 U.S.C. § 1964(c). In *Carpenters*, the court implicitly acknowledged that some members of the proposed class lacked RICO injury when it "carved out" TPPs that renegotiated their contracts after the AWP increases. *Carpenters I*, 244 F.R.D. at 87. However, this carve-out did not capture all of the potential "no-injury" TPPs. Other TPPs may have been insulated from injury because of "heat seeking missiles," "pass throughs," rebate increases, and similar contract provisions. *Id.* at 86. The *Carpenters* court saw no need examine these varied circumstances on an individualized basis.

McLaughlin, on the other hand, applied a rigorous "but for" test of RICO injury: "Only by showing that plaintiffs paid more for light cigarettes than they would have but for defendants' misrepresentations can plaintiffs establish the requisite injury under civil RICO." *McLaughlin*, 2008 WL 878627, at * 7. This requirement defeated class certification because "individual smokers would have incurred different losses depending on what they would have opted to do, but for defendants' misrepresentation." *Id.* at *8. For example,

> smokers who would have purchased full-flavored cigarettes instead of Lights had they known that Lights were not healthier would have suffered no injury because Lights have always been priced the same as full-flavored cigarettes. By contrast, those who would have quit smoking altogether could recover their expenses in purchasing Lights. And those who would have continued to smoke, but in greater moderation, could recover something in between. Thus, on the issue of out-of-pocket loss, individual questions predominate; plaintiffs cannot meet their burden of showing that injury is amenable to common proof.

Id.

Damages

Finally, the courts disagreed as to whether damages could be calculated on an aggregate, class-wide basis. From the outset, the *Carpenters* court made it clear that it did not view the calculation of damages as a particularly high hurdle to class certification. It emphasized that on a motion for class certification, plaintiffs' burden is merely to present the court with a "likely" method for determining class damages." *Carpenters I*, 244 F.R.D. at 89. It even went so far as to imply that the burden was on defendants to demonstrate that plaintiffs' approach to damages is "fundamentally flawed." *Id.* The court then engaged in a lengthy analysis of the damages models that plaintiffs' experts had proposed, and potential problems with those models proffered by the defendants. But throughout this analysis the court assumed that damages could be somehow computed on an aggregate basis consistent with Rule 23.

The *McLaughlin* court proceeded from the opposite assumption. It was highly critical of the district court's decision, which had "concluded that plaintiffs could prove damages on a class-wide basis, and individual plaintiffs could then claim shares of this fund." *McLaughlin*, 2008 WL 878627, at * 11. The Second Circuit held that such "fluid recovery" is "forbidden" because it is not "authorized by the text or by any reasonable interpretation" of Rule 23. *Id.* The court explained that:

> such an aggregate determination is likely to result in an astronomical damages figure that does not accurately reflect the number of plaintiffs actually injured by defendants and that bears little or no

> relationship to the amount of economic harm actually caused by defendants. This kind of disconnect offends the Rules Enabling Act, which provides that federal rules of procedure, such as Rule 23, cannot be used to "abridge, enlarge, or modify any substantive right."

Id.

Going Forward

Three years ago, Congress federalized most class actions by enacting the Class Action Fairness Act in hopes of reducing "forum shopping." But the stark contrasts between *Carpenters* and *McLaughlin* on the elements of civil RICO and the standards for class certification demonstrate an uncomfortable truth about current class action practice—the forum still counts. It has been a decade since the U.S. Supreme Court handed down significant class certification decisions in *Amchem* and *Ortiz*.[8] Until it does so again, this variability is likely to continue. The forthcoming decision in *Bridge* will, hopefully, create some certainty regarding the element of reliance. But because *Bridge* is not a class action, lower courts may take different views on its impact on the class certification analysis. The prime importance of the forum in class action practice is likely to continue.

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[8] *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591 (1997); *Ortiz v. Fibreboard Corp.*, 527 U.S. 815 (1999).

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