

**IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

REGSCAN, INC.	:	CIVIL ACTION
	:	
v.	:	
	:	
DEAN MARK BREWER, et al.	:	NO. 04-6043

MEMORANDUM

Baylson, J.

August 23, 2005

In a prior Memorandum and Order dated June 17, 2005, the Court directed counsel to file a memorandum as to the sufficiency of Plaintiff’s claims under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §1964(c) (“RICO”), as explained in some detail in Plaintiff’s RICO Case Statement, on two issues, the naming of Defendant Citation Publishing as the “enterprise,” and the sufficiency of Plaintiff’s allegations of causation. Both counsel have responded, and the Court will now rule on the adequacy of Plaintiff’s RICO case statement on these two issues.

As to the identity of the enterprise, Citation Publishing, albeit a Defendant in this case, and specifically noted as the “enterprise,” is not a Defendant in the RICO Count. Although the Supreme Court in Cedric Kushner Promotions, Ltd. v. King, 533 U.S. 158 (2001) specifically held that the RICO enterprise may not also be a party defendant (for most RICO claims), the distinction need only be a formal one. In this case, however, the Court notes that the Plaintiff’s RICO Case Statement makes it clear that a number of the acts which are asserted to be RICO violations, were taken by the corporation – although Plaintiff sometimes states the actions of the individual defendants, not the corporation. The Court is not sure exactly how Plaintiff will address this issue during discovery, at the dispositive motion stage, or at trial, but it would appear

to be a significant problem, although not grounds for dismissal of the RICO claim at this initial pleading stage of the case. Further, the fact that Citation Publishing is a Defendant in other counts might present significant problems of proof and allocation of damages between the RICO and other claims, but the Court would not be justified in dismissing Plaintiff's RICO claim at this time.

As to causation, in Holmes v. Securities Investor Protection Corp., 503 U.S. 258 (1992), the Supreme Court held squarely that the statutory language of RICO requires a showing of both "direct" and "proximate" causality. In this case, as noted in the June 17, 2005 Memorandum, Plaintiff alleges causation because Defendants, by their allegedly unlawful activities, have been able to cut their own costs and save expenses, and thus Plaintiff, a competitor, has suffered a loss in sales.

Plaintiff's 52-page RICO Case Statement is mostly devoted to the specific facts concerning the alleged RICO violations, predicate acts, and similar aspects dealing with the alleged violation of RICO by the Defendants. The predicate acts alleged involve mail fraud, wire fraud, and embezzlement of funds from employee welfare benefit plans and employee pension benefit plans. These alleged violations take up the first 44 pages of Plaintiff's fifty-two-page RICO Case Statement.

Beginning at page 45, Plaintiff details a number of allegations under the heading "The Direct Causal Relationship Between the Alleged Injury and the Violation of the RICO Statute" and asserts that the Plaintiff has "generally suffered damages in the form of lost revenue from lost sales and depressed market prices" and then identifies a number of large entities to which Plaintiff alleges it can no longer make sales because "Citation's impossibly low retail prices have

depressed prices in the market where RegScan and Citation compete by approximately 25%, resulting in decreased revenue to RegScan.”

Plaintiff states that the individual Defendants’ violations of RICO are related to Plaintiff’s damages and injuries for several reasons:

1. The individual Defendants’¹ practices have allowed Citation to keep its operating expenses impossibly low, which has allowed Citation to keep its sale prices low.

2. As a result of the individual Defendants’ allegedly unlawful activities, Citation has utilized RegScan’s proprietary and confidential information at no cost to Citation and with no revenue to RegScan.²

3. Citation has made a profit from the individual Defendants’ knowledge of RegScan’s effort and expense in developing its sales, marketing and database, and has increased RegScan’s litigation costs.

4. Defendants’ unlawful use of funds from employee benefit and pension plans and failure to pay its employees’ wages have given Citation a source of funding and allowed them to

¹As noted above, although the RICO Case Statement at some points does delineate that these allegedly wrongful acts were undertaken by the individual Defendants, and not by Citation, the very nature of the acts described makes them corporate acts rather than actions by the individuals acting in their individual capacities. Of course, a corporation can only act through its officers and employees, but Plaintiff may have a difficult time demonstrating that only the individual Defendants are liable under RICO when they were clearly acting as officers or employees of Citation. It is possible that Citation is not truly an “enterprise” for RICO purposes. Nonetheless, the Court must act cautiously at the pleading stage of the case, and let the facts develop through discovery. This is particularly true where several of Plaintiff’s causes of action, including its federal Lanham Act violation, are continuing.

²The Court queries whether some of the Plaintiff’s claims relating to appropriation of its intellectual property are appropriate predicate acts under RICO, but they may be covered under Plaintiff’s Lanham Act claims.

avoid the cost of obtaining funds.

On page 49, Plaintiff describes its alleged injury to business or property and indicates that as a result of the alleged unlawful activities of the individual Defendants, Citation's operating expenses have been lowered and the retail prices at which Citation is able to offer its goods and services for sale in the market are "impossibly low" and have caused RegScan to offer its products and services for sale at below market retail prices insufficient to maintain its desired profit margins. RegScan alleges it has lost sales to customers because of Citation's impossibly low retail prices, which has in turn reduced RegScan's cash flow and its ability to make significant capital expenditures, reduced RegScan's value as a going concern, and deprived RegScan's employees of business opportunities.

In Holmes, the Supreme Court gave three reasons for its requirement of direct and proximate causation. The first was that, without a direct injury, "the more difficult it becomes to ascertain the amount of a plaintiff's damages attributable to the violation, as distinct from other, independent, factors; [s]econd, quite apart from problems of proving factual causation, recognizing claims of the indirectly injured would force courts to adopt complicated rules apportioning damages among plaintiffs removed at different levels of injury from the violative acts, to obviate the risk of multiple recoveries; [a]nd, finally, the need to grapple with these problems is simply unjustified by the general interest in deterring injurious conduct, since directly injured victims can generally be counted on to vindicate the law as private attorneys general, without any of the problems attendant upon suits by plaintiffs injured more remotely." 503 U.S. at 269-70 (citations omitted).

In this case, the injuries alleged by Plaintiff may turn out not to be direct and proximate.

As one example, although Plaintiff adequately alleges that it and Citation are direct competitors, and Citation has achieved lower costs through its allegedly illegal activities, it is possible that RegScan has higher costs than Citation for reasons completely unrelated to the alleged illegal activities of Defendants. Further, the damages proof in this case, at trial, could easily require difficult comparisons of the operating structure of both entities, and also possible comparison to other third parties in the marketplace as well. For example, without any relationship to Defendants' allegedly illegal activities, assuming the facts showed that Plaintiff paid higher salaries, or had higher lease expenses, or had an inefficient sales organization – all factors unrelated to the alleged RICO violations – then, there would be no direct and proximate relationship between the alleged RICO violations and the loss of income by Plaintiff.

This Court has previously dismissed a RICO claim for, inter alia, lack of proximate causation, in Bonavitacola Elec. Contractor, Inc. v. Boro Developers, Inc., 2003 WL 329145 (E.D. Pa. 2003)(Baylson, J.), aff'd, 87 Fed.Appx. 227, 2003 WL 23155074 (3d Cir. 2003), because in a motion to dismiss the amended complaint, the plaintiff failed to show how the defendant's alleged RICO violations influenced a particular customer's decision to award a contract to the defendant, a competitor of the plaintiff.

Both parties in this case cited the Second Circuit's decision in Ideal Steel Supply Corp. v. Anza, 373 F.3d 251 (2d Cir. 2004), holding that because the complaint alleged that a defendant engaged "in a pattern of fraudulent conduct that is within the RICO definition of racketeering activity and that was intended to and did give the defendant a competitive advantage over the plaintiff, the complaint adequately pleads proximate cause, and the plaintiff has standing to pursue a civil RICO claim." Id. at 263. In Ideal, the plaintiff alleged defendant's allegedly

fraudulent scheme was implemented for the purpose of diverting customers from plaintiff. Plaintiff alleged a scheme regarding sales taxes required by law, which the plaintiff did collect, but the defendant did not collect; the plaintiff and defendant sold the same products and their retail stores were very close. Thus, the lower bottom line cost available to cash purchasers from plaintiff, as a result of not paying sales tax, influenced customers to purchase from defendant rather than plaintiff.

After reviewing the allegations in the Complaint and the RICO Case Statement, and considering that this case is still at the pleading stage,³ that Bonavitacola involved different facts and the Third Circuit's affirmance was non-precedential, and that the Plaintiff's claims are arguably within the ambit of the Second Circuit's holding in Ideal, the Court has decided not to dismiss Plaintiff's RICO Complaint at this stage. However, the Court has substantial reservations about the viability of Plaintiff's RICO claim and will revisit these issues at an appropriate time after Plaintiff has been given an opportunity for discovery and possible clarification of the issues raised in this Memorandum.

The accompanying Order will direct the parties to focus on discussing a pretrial schedule, to be followed by a Rule 16 conference with the Court.

³Compare Callahan v. A.E.V., Inc., 182 F.3d 237 (3d Cir. 1999), where small beer distributors sued competing larger distributors with antitrust and RICO claims, and summary judgment was improperly granted as to causation on the antitrust claim, but was affirmed on the RICO claims. Because the decision in Callahan was based on a full factual record, it is not precedent to dismiss the RICO claims here.

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ORDER

AND NOW, this 23rd day of August, 2005, it is hereby ORDERED as follows:

1. Defendants' Motion to Dismiss Plaintiff's RICO Claims (Doc. No. 11) is DENIED, without prejudice to renewal at an appropriate time.
2. Counsel are directed to discuss with each other a pretrial schedule that will include coordination and prevention of duplication with the state court proceedings and discovery, completion of fact discovery, a schedule for expert witness reports and depositions, a settlement conference, and the filing of pretrial memoranda and dispositive motions, preferably completed within eight (8) months. Counsel are encouraged to develop a proposed stipulated pretrial order, and are required to submit either a stipulated order, or separate proposed orders, by September 9, 2005.
3. A telephone conference with counsel will be held on Tuesday, September 13, 2005, at 4:45 p.m., to discuss these matters. Plaintiff's counsel will initiate the call, and when all counsel are on the line, call chambers at 267.299.7520. Attached is a copy of the Court's Pretrial and Trial Procedures.

BY THE COURT:

/s/ Michael M. Baylson
Michael M. Baylson, U.S.D.J.