

New Jersey Law Journal

VOL. CLXXXIX—NO.4—INDEX 336

JULY 23, 2007

ESTABLISHED 1878

IN PRACTICE

BANKRUPTCY LAW

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RICO Still an Option for Defrauded Creditors

A creditor whose debt was rendered valueless by fraud can bring a civil RICO claim

The Racketeer Influenced and Corrupt Organizations Act, better known by its acronym, RICO, has been the subject of numerous decisions that have severely limited its scope. In the creditors' rights context, however, a creditor may still recover losses caused by a debtor's scheme to defraud.

RICO is a federal statute that creates both criminal and civil liability for persons who engage in enterprise criminality. 18 U.S.C. § 1961. The statute's civil provisions allow a plaintiff to recover not only actual damages, but triple damages, attorney's fees and costs of suit. This mechanism led to a boom in the use of civil RICO in a variety of contexts. This expansive use, in turn, engendered a judicial backlash. Thus, while the statute has no such limiting language, the federal courts have often emphasized their perception, especially in the civil context, that the statute was passed solely to address injuries committed by traditional organized criminals and, therefore, RICO should be

read carefully to insure that its scope does not become too broad. *See e.g. Allstate Ins. Co. v. Valley Physical Medicine & Rehabilitation, P.C.*, 475 F. Supp. 2d 213, 227 (E.D.N.Y. 2007) (stating that RICO, though broadly worded, is meant to eliminate organized crime); *United States Fire Ins. Co. v. United Limousine Service, Inc.*, 303 F. Supp. 2d 432, 443 (S.D.N.Y. 2004) (holding that courts must attempt to limit civil RICO claims by focusing on the nature of alleged racketeering).

The courts have read various glosses on the language of the statute that have limited its range in the civil context. *See e.g. Anza v. Ideal Steel Supply Corp.*, 126 S.Ct. 1991 (2006) (limiting the right to sue under RICO to those whose injuries are very closely tied to the racketeering activity); *DeFalco v. Bernas*, 244 F.3d 286, 307 (2d Cir. 2001) (holding that a corporation cannot be liable under RICO even though its employees run the affairs of the corporation through a pattern of racketeering).

The conflict between this trend and the duty of the courts to simply apply the statutory language as written (regardless of the purposes that motivated the passage of the statute) was even noted by U.S. Supreme Court Justice

Clarence Thomas, generally no friend of overly expansive federal statutes, in his dissent in *Anza*, the most recent RICO case to be decided by the Supreme Court.

Nevertheless, the RICO statute, even while curtailed by the courts, still retains vitality in certain circumstances of interest to creditors. Specifically, the Second Circuit's seminal decision in the 1988 case of *Bankers Trust Company v. Rhoades*, 859 F.2d 1096 (2d Cir. 1988), remains viable. In *Bankers Trust*, the Second Circuit recognized the right of a creditor who had been defrauded by its debtor to bring a civil RICO action. Similarly, in *Stochastic Decisions, Inc. v. Di Domenico*, 995 F.2d 1158 (2d Cir. 1993), the Second Circuit affirmed various portions of a civil RICO jury verdict in favor of just such a defrauded creditor. Both *Bankers Trust* and *Stochastic Decisions* remain good law; indeed, neither the Second Circuit nor the Supreme Court has ever called the paradigm of these cases into question. Thus, a creditor who, through a series of frauds, has had its debt rendered valueless, can, in the right circumstances, bring a civil RICO claim.

In an action commenced in the early 1980s, *Bankers Trust Company* (*Bankers*) plead a civil RICO claim against a group of debtors. Specifically, *Bankers* alleged that the defendants — a group of individuals who owned, directed and controlled *Braten Apparel Corporation* (*BAC*) — put *BAC* into bankruptcy while fraudulently hiding *BAC*'s largest asset, *Brookfield Clothes, Inc.* (*Brookfield*), from *BAC*'s creditors. Several years into the scheme to hide *BAC*'s assets from *Bankers* and

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other creditors, the individual defendants, in an attempt to protect BAC's Brookfield asset from attachment, began to deplete the Brookfield asset. Specifically, the individuals concealed and depleted the assets "through a wide variety of methods, including fraudulent stock transfers, transfers of corporate assets to other companies and individuals without fair consideration, and transfers of monies in corporate accounts to satisfy personal debts."

Bankers brought suit alleging that the series of actions designed to conceal BAC's assets constituted a "pattern of racketeering activity" in violation of RICO. After initial dismissals, on appeal, the Second Circuit allowed the claim to proceed. The Second Circuit found that Bankers had alleged that it had been injured by the defendants' actions — including bribery, perjury and fraud — and that it had a right to recover for the injury.

The Second Circuit further explained that Bankers was entitled to recover the past legal fees and expenses that it spent trying to undo defendants' various fraudulent activities, which were designed to hide BAC's assets. The Second Circuit also held, however, that Bankers could not, at that time, recover for its lost debt, because that very issue was pending in the bankruptcy court and it was possible that Bankers would obtain some relief in the form of payment for its debt. The court held, however, that once its debt was determined uncollectible from BAC, then "Bankers' injury will be ascertainable" and Bankers would have four years to "bring a civil RICO action to recover the dam-

ages it has suffered" in losing its ability to collect its debt because of the defendants' acts of fraud, bribery and perjury.

Similarly, in *Stochastic Decisions, Inc.*, the Second Circuit affirmed a verdict in which the creditor had won a civil RICO case after a 12-day trial. The owners of Eagle Bus, Inc. (Eagle) fell behind in the payments that Eagle was required to make to various creditors, including Stochastic Decisions. Eagle filed for bankruptcy but concealed assets from the bankruptcy court and began surreptitiously transferring assets from Eagle to another corporation without true consideration. The owners of Eagle transferred all of their assets and the assets of Eagle to an attorney, who then used the assets to pay personal debts. Ultimately, Stochastic filed a civil RICO suit alleging that "bankruptcy fraud, wire fraud, and mail fraud" prevented "Stochastic from collecting the amounts it was owed." On the RICO claim, the court awarded triple the creditor's legal costs associated with "attempting to collect" its debts because those fees represented "damages attributable and foreseeable by the conspirators, resulting directly from the RICO violations." Further, the district court awarded Stochastic the fees it expended in prosecuting the RICO action pursuant to the statute. The creditor was, however, unable to collect the lost debt as "RICO damages" because that injury was not sufficiently related to the fraudulent activity. The Second Circuit affirmed every aspect of the district court's final judgment.

While the scope of *Bankers Trust* and *Stochastic Decisions* have, to some degree, been limited by subsequent cases

from the Second Circuit and the Supreme Court, the fact remains that neither has ever been explicitly or implicitly overruled. Thus, creditors whose debts have been rendered uncollectible may bring a RICO action if they can show that the actions of the debtor rise to the level of a "pattern of racketeering activity." Such a showing requires that the debtor engage in a series of sham transactions designed to frustrate collection over the course of many months — in the Second Circuit it has been suggested that almost two years worth of such conduct is necessary to create a sufficient "pattern." Further, the damages that are recoverable will be strictly limited to those directly attributable to the fraudulent actions. Finally, the ability of a creditor to bring an action styled on *Bankers Trust* and *Stochastic Decisions* will be highly influenced by the RICO law of the Court of Appeals in which the fraud has occurred.

RICO as written is a broadly worded statute that provides relief to entities that have been the victims of a pattern of fraud. The interpretation of the statute by the courts of the United States have limited the scope of RICO and made it difficult and often impossible to state a valid cause of action. Nevertheless, the rights of creditors to bring RICO actions in the right circumstances — circumstances first outlined by the Second Circuit Court of Appeals in *Bankers Trust* — have not been eliminated and can, in the appropriate cases, be an effective use of the statute to recoup damages. ■