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RICO Damages After Set-Off: Treble vs. Double Recoveries

The Racketeering Influenced Corrupt Organizations Act (RICO) is an enormously powerful tool designed to combat racketeering activity. On the civil side, RICO empowers victims to act as private attorneys general, rewarding the successful plaintiff with treble damages and attorney's fees.

The mere filing of a RICO action can have a devastating effect on a defendant. Rumors of corruption spread quickly, and a business embroiled in allegations of a RICO conspiracy risks losing its hard-earned reputation overnight.

The specter of treble damages can snap to attention even the most defiant corporate executives, fearful of a mortal blow to their company. For these reasons, civil RICO has been described as "the litigation equivalent of a thermonuclear device."[1]

Facing grave risks, many corporate defendants choose to settle a RICO case early, buying peace and certainty and leaving their codefendants to fight this wrenching battle alone. Given that the law abhors double recoveries, what damages remain at stake after a settlement with some, but not all, defendants?[2] Put another way, in the context of civil RICO, what is the appropriate method to calculate a set-off of settlement payments? The U.S. Court of Appeals for the Second Circuit has not yet resolved this pivotal question.

Measuring the 'Thermonuclear' Threat

Suppose your client has been harmed to the tune of $30 million; you bring a civil RICO claim seeking $90 million in treble damages against several defendants; and you settle with two defendants for a total of $40 million early in the proceedings.

Do you subtract the settlement amount from the total damages before or after trebling the compensatory (i.e., actual) damages? The answer will determine the continued viability of your case. If you calculate the set-off before trebling, you will extinguish your claim, because the set-off ($40 million) will exceed the actual damages ($30 million). If you calculate the set-off after trebling, you are left with a claim for $50 million and your case is very much in play.

Recent Eastern District Court Ruling

State Farm Mut. Auto. Ins. Co. v. Kalika, 04 CV 4631, 2007 WL 4373600 (E.D.N.Y. Dec. 11, 2007), examines the effect of a settlement set-off on a nonsettling defendant's liability and highlights RICO's muscle. In that case, State Farm sued several doctors for their alleged participation in a fraudulent scheme to bill State Farm for medically unnecessary tests performed on State Farm-insured individuals. After a default judgment was entered against one of the defendants, Dr. Yaldizian, the district court held an inquest to determine the damages against him. Because certain other defendants had already settled with State Farm for an amount totaling $1.025 million, the court was confronted with the task of determining the amount to set off against Dr. Yaldizian's liability.[3] The court found that the defendants' collectively caused State Farm to pay $1,142,091 for medically unnecessary procedures, and that Dr. Yaldizian individually caused State Farm to incur only $39,392 in fraudulent charges.[4] Acknowledging that the Second Circuit has not yet determined whether a settlement set-off in a RICO case should occur before or after trebling actual damages, the court held that Dr. Yaldizian was jointly and severally liable for $2,401,273, which equaled the trebled sum of damages caused by the defendants' scheme less the amounts received in settlement.[5] Thus, by causing less than $40,000 in damages to State Farm, Dr. Yaldizian was held responsible for nearly $2.5 million in damages as a result of his participation in a RICO conspiracy.

Precedent in Other Circuits

The *State Farm* court relied mainly on decisions in the Fourth and Seventh circuits to support its view that civil RICO set-offs should occur after trebling actual damages.[6] *Morley v. Cohen*, 888 F.2d 1006 (4th Cir.1989), involved a RICO claim arising from a tax shelter investment that the plaintiffs contended was, in fact, a scheme to defraud investors.[7] The plaintiffs

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brought RICO and common-law claims against several defendants; they settled with one defendant and won a jury verdict against two others.[8] Drawing upon set-off principles established in antitrust (another treble damages regime), the Fourth Circuit ruled that a set-off should be made after trebling actual damages.[9]

Morley accords with a preceding Seventh Circuit decision, *Liquid Air Corp. v. Rogers*, 834 F.2d 1297 (7th Cir. 1987) (en banc), which concerned a RICO conspiracy perpetrated by a competitor and a disloyal employee in the liquid gas business. Sometime after a jury awarded $750,000 in compensatory damages for the replacement value of more than 3,000 gas cylinders and the lost rent associated with each, the defendants returned 530 cylinders and sought to obtain a set-off for their value.[10] The Seventh Circuit affirmed the district court's decision to set off the value of the returned cylinders after trebling the compensatory damages, reasoning that a post-trebling set-off "is more likely to effectuate the purposes behind RICO."[11]

Potential Divergence by the Second Circuit

Notwithstanding the reasoning articulated in *State Farm*, *Morley*, and *Liquid Air*, it is questionable whether the Second Circuit would affirm a decision setting off RICO damages after trebling actual damages. For one thing, the RICO winds have changed due to *Anza v. Ideal Steel Supply Corp.*, 126 S.Ct. 1991 (2006), a June 2006 decision by the Supreme Court which substantially limited the scope of civil RICO claims by narrowly defining "proximate cause." Additionally, there is case law in the Second Circuit to support the view that a set-off in a RICO case should be calculated prior to trebling damages. See *Commercial Union Assurance Co. v. Milken*, 17 F.3d 608 (2d Cir. 1994) (*Milken*).

Milken arose in the context of Ivan Boesky's 1980s insider trading scandal. Shortly after Mr. Boesky reached a plea and cooperation agreement with the government and a liquidation trustee was appointed for Ivan Boesky & Co. LP, investors in Mr. Boesky's limited partnership sued for damages pursuant to RICO and other claims.[12] Within the first 10 months of litigation, the liquidation trustee's sale of assets from Mr. Boesky's limited partnership yielded the plaintiff investors a 10.2 percent return on their investment while enabling the plaintiffs to retain their interests in the partnership.[13] Further, the plaintiffs received additional money from several third-party settlements.[14]

Although the Second Circuit was sympathetic to plaintiffs' cries of wrongdoing, it affirmed the district court's grant of summary judgment to defendants Michael and Lowell Milken because it would not countenance a RICO claim where it perceived that the plaintiffs had been made whole.[15] The court confronted *Liquid Air*, and distinguished that case by noting that *Liquid Air* affirmed a set-off after trebling where the defendants returned lost goods following the entry of a RICO judgment, whereas the plaintiffs in *Milken* were repaid within 10 months of the commencement of their suit.[16] (The Milken brothers, incidentally, did not escape liability. *Milken* arose after certain of the plaintiffs opted out of a settlement agreement that yielded a $500 million contribution by Michael Milken.)[17]

Strident RICO advocates cringe at *Milken* and any attempt to extend its effect, arguing that a RICO claim should not be extinguished unless and until the plaintiff is recompensed 300 percent (i.e., treble damages). These staunch supporters argue that *Milken* thwarts RICO's deterrent value. Given that the Second Circuit is traditionally an inviting court for plaintiffs, many might expect the Court to strike a balance between *Milken's* preclusive effects and RICO's remedial purposes. It could do this by holding that any settlement payments satisfying less than 100 percent of incurred damages in a RICO action are to be used as a set-off after trebling compensatory damages; such a decision would respect *Milken* and limit its thrust.[18] Yet, the Supreme Court reversed the Second Circuit in *Anza*, concluding that the circuit's perception of proximate cause was too broad. Whether *Anza*, coupled with a recent spate of conservative rulings by the High Court, will acutely affect the Second Circuit is a ripe question.

Gaming the System

Even if the Second Circuit were to rule that a set-off in a RICO case should occur after trebling actual damages, an equally relevant and intriguing question is whether, to the extent a contribution is made prior to the entry of judgment, the timing of such contribution matters. Would our home circuit permit a doomed defendant to extinguish a RICO claim on the eve of verdict by tendering 100 percent (instead of 300 percent) of compensatory damages without offering a penny in attorney's fees? *Milken* and its progeny suggest that it would. See *Milken* at 612 ("We recently ruled that after a RICO claim has been successfully collected it is 'abated pro tanto, prior to any application of trebling.'").[19]

'Central Concern'

Indeed, five years after *Milken*, the court described its "central concern" in that case as one focused on the fact "that the plaintiffs had suffered no direct pecuniary losses because they had recouped their entire initial investment as well as a return on their investment."[20] Payment of all damages on the eve of a verdict would alleviate this "central concern."

Future plaintiffs can only hope that, when the need arises, the court will distinguish *Milken* and rebuff a defendant's transparent attempt to eviscerate RICO by gaming the system.

1. *Miranda v. Ponce Fed. Bank*, 948 F.2d 41, 44 (1st Cir. 1991).
2. Although the Second Circuit has not squarely addressed the question of joint and several liability in the context of civil RICO, "[e]very circuit in the country that has addressed the issue has concluded that the nature of…civil…RICO offenses requires imposition of joint and several liability because all defendants participate in the enterprise responsible for the RICO violations." *United States v. Phillip Morris USA Inc.*, 316 F.Supp.2d 19, 27 (D.D.C. 2004) (collecting circuit cases). Accordingly, this article assumes that joint and several liability applies to civil RICO claims.
3. *State Farm*, 2007 WL 4373600, at *9.
4. Id. at *8.
5. Id. at *9.
6. Id.
7. *Morley*, 888 F.2d at 1008.
8. Id. at 1009.
9. Id. at 1013.
10. *Liquid Air*, 834 F.2d at 1301.
11. Id. at 1310.
12. Boesky's fund was renamed to CX Partners LP after his ignominious fall from grace. *Milken*, 17 F.3d at 610.
13. Id. at 611-12.
14. Id.
15. Id. at 609.
16. Id. at 613 (citing *Liquid Air*, 834 F.2d at 1310).
17. Id. at 611.
18. See id. at 612 ("If a portion or all of their investment in the partnership was unrecoverable, a treble damage award might be appropriate….").
19. Internal quotation marks and citation omitted.
20. *Carlisle Ventures Inc. v. Banco Espanol de Credito, S.A.*, 176 F.3d 601, 606 (2d Cir. 1999).