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– The Thermonuclear Option

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The Thermonuclear Option:

Civil RICO as an Asset Recovery Tool in U. S. Enforcement Efforts post-*Smagin*

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Introduction

In recent years, the United States has received heightened attention as a haven for asset secrecy and inventive wealth-protection devices – and, consequently, a forum for asset-recovery litigation. The Supreme Court recently weighed in on the fight against fraudulent judgment-evasion schemes when it held that foreign plaintiffs with arbitration awards enforceable in the United States may have standing to assert civil RICO claims to enforce those awards. *See Yegiazaryan v. Smagin,* 143 S. Ct. 1900 (2023) (*"Smagin"*).

Civil RICO, labeled by one circuit court "the litigation equivalent of a thermonuclear device," packs a powerful punch – combining considerable stigma, the threat of high litigation costs and potential liability for treble damages and attorneys' fees. *Miranda v. Ponce Fed. Bank*, 948 F.2d 41, 44 (1st Cir. 1991). Coupled with robust discovery rights attendant to federal court litigation, RICO can be a powerful and effective tool in a U.S. asset-recovery campaign.

While *Smagin* clarified standing to assert RICO claims, it did not modify the daunting burdens a plaintiff must clear to prevail on such claims. Most private RICO claims fail. *See Gross v. Waywell,* 628 F. Supp. 2d 475, 480 (S.D.N.Y. 2009) (surveying four years of civil RICO cases and determining "all resulted in judgments against the plaintiffs," with none even surviving to trial). The *Gross* court described civil RICO as a "siren's song," drawing "spellbound plaintiffs foundering against the rocks." *Id.* at 479.

Smagin may have amplified the siren's call around the world, but the rocks remain. This article seeks to shed light on the rocks and RICO's potential role in piercing complex schemes to evade enforcement. We are only aware of one case in which a foreign plaintiff successfully used RICO to enforce an arbitration award and reach trial, *Tatung v. Shu Tze Hsu*, 217 F. Supp. 3d 1138 (C.D. Cal. 2016) (on which one of the authors served as lead plaintiff's counsel), and that was only after surviving 35 motions to dismiss and summary judgment motions. We draw on our experience successfully navigating that case to highlight the unique complexities of using RICO as an asset-recovery tool and factors creditors should consider when assessing whether theirs is the rare case in which the advantages of this nuclear option outweigh the pitfalls.

THE WILD WEST AND THE NEED FOR SHARPER TOOLS TO PIERCE U.S. MONEY LAUNDERING AND WEALTH-DEFENSE SCHEMES

The past few years have illuminated the United States as a preeminent destination for wealth-defense and asset-protection strategies. The 2021 Pandora Papers exposed how billionaires utilize extreme financial secrecy laws of western states like South Dakota, Alaska, Nevada and Wyoming to move assets off their balance sheets while maintaining the privileges of ownership. A Bloomberg review of state records tallied deposits of a *half-trillion dollars* just in trusts created under South Dakota's privacy-driven laws. *See* Anders Melin, *The World's Rich And Powerful Are Stashing $500 Billion In This Tax Haven,* FINANCIAL ADVISOR MAGAZINE (Oct. 14, 2021), https://www.fa-mag.com/news/the-world-s-rich-and-powerful-are-stashing--500-billion-in-this-tax-haven-64394.html?section=3. And, as of 2023, the Tax Justice Network now ranks the United States as number one in its Financial Secrecy Index. *See Financial Secrecy Index 2022,* TAX JUSTICE NETWORK, https://fsi.taxjustice.net. With the sheer volume of hidden and open wealth flowing through the United States, there has never been a greater need for sharp tools to enforce creditor rights against debtors willing to go to great lengths to avoid collection.

American asset-recovery practitioners already have a well-honed arsenal of tools for investigations and enforcement litigation. In addition to far-reaching long-arm jurisdiction, the United States has uniquely expanded the scope of discovery. *See, e.g. In re Ishihara Chem. Co.,* 121 F. Supp. 2d 209, 225 (E.D.N.Y. 2000) ("[T]he U.S. system of broad discovery is fundamentally different from that of most foreign countries . . . most other countries fiercely limit the scope of discovery to protect personal privacy and consider U.S. discovery to be a fishing expedition.") (citation and quotation omitted). The opportunity to add RICO claims to the mix is compelling. RICO puts at issue a broad array of facts, often delving deeply into the internal affairs and relationships among all the players in an alleged RICO enterprise. *See, e.g., Black v. Ganieva,* 619 F. Supp. 3d 309, 334 (S.D.N.Y. 2022). Discovery in a civil RICO case will often lead to a deep understanding of how – *and where* – a defendant moves assets. Along with its mandatory treble damages and fee-shifting provisions, the potential availability of RICO in asset-recovery litigation is alluring.

THE SIREN'S SONG: THE U.S. SUPREME COURT CONFIRMS WHEN FOREIGN PLAINTIFFS CAN ASSERT CIVIL RICO CLAIMS TO ENFORCE NON-U.S. ARBITRATION AWARDS

The Supreme Court's decision in *Smagin* resolved a split among lower courts over whether foreign creditors have standing to assert a civil RICO claim to enforce arbitration awards and judgments. The discord stemmed from *RJR Nabisco, Inc. v. European Cmty.,* 136 S. Ct. 2090 (2016), where the Court considered whether RICO applies extraterritorially. Concerned that allowing extraterritorial reach of private claims could put the statute in conflict with laws of other countries providing redress for such injuries, the Court held that civil RICO "does not allow recovery for foreign injuries," and a private RICO plaintiff must "allege and prove a *domestic injury* to business or property." *RJR Nabisco,* 136 S. Ct. at 2096, 2111 (emphasis added). Unfortunately, *RJR Nabisco* provided little guidance on how to identify or define a domestic injury, and a split among lower courts ensued.

District courts in California and New York promptly adopted competing schools of thought. In *Bascuñan v. Elsaca,* 2016 WL 5475998 (S.D.N.Y. Sept. 28, 2016), the Southern District of New York applied RJR Nabisco to section 1964(c) claims by a Chilean citizen and resident. Noting that a partial dissent by Justice Ginsberg posited that the majority decision in RJR Nabisco makes a "RICO private cause of action 'available to domestic but not foreign plaintiffs,'" the court held that a plaintiff feels the effects of a financial injury in the place of its residence, and therefore the plaintiff had not suffered a domestic injury addressable by RICO's private right of action. Id. at 5-6 (citation omitted).

Just weeks later, in *Tatung v. Shu Tze Hsu,* 217 F. Supp. 3d 1138 (C.D. Cal. 2016), the Central District of California reviewed *RJR Nabisco* and the nascent *Bascuñan* decision in a case by a Taiwanese plaintiff seeking to enforce an arbitration award against an alleged global RICO enterprise used to siphon assets of a California debtor to related offshore parties. The court found the *Bascuñan* effects test would "amount[] to immunity for U.S. corporations who, acting entirely in the United States, violate civil RICO at the expense of foreign corporations doing business in this country." *Id.* at 1155. Instead, the court focused on where the defendants' conduct was directed and

recognized that, armed with an arbitration award and judgment enforceable in California, the plaintiff had domestic enforcement rights, which the defendants specifically targeted. *Id.* at 1157.

This split between assessing where the effects of racketeering activity are felt and assessing where the activity is targeted quickly expanded to the circuit courts. The Seventh Circuit embraced the New York approach and "adopted a rigid, residency-based test for domestic injuries involving intangible property, such as a judgment," which "locates an injury to intangible property at the plaintiff's residence." *Smagin,* 143 S. Ct. at 1907 (citing *Armada (Sing.)* PTE *Ltd. v. Amcol Int'l Corp.,* 885 F. 3d 1090 (2018)). Meanwhile, *Bascuñan* made its way through two appeals, and the Second Circuit ultimately reversed, holding a foreign plaintiff may allege a domestic injury where the injury is to property the plaintiff maintains in the United States, but limited its holding to tangible property. *Bascuñan v. Elsaca,* 874 F.3d 806, 814 (2d Cir. 2017).

The Third Circuit also rejected the Seventh Circuit's effects test and instead adopted a context and case-specific analysis. *See Humphrey v. GlaxoSmithKline PLC*, 905 F.3d 694, 709 (3d Cir. 2018). In rejecting the Seventh Circuit's bright-line rule, the Third Circuit held that when assessing whether alleged injuries are domestic or foreign, courts "must engage in a fact-intensive inquiry that will ordinarily include consideration of multiple factors that vary from case to case," and which are not limited to the location of the plaintiff's residence. *Id.* at 701, 707.

Post-*GlaxoSmithKline*, the *Smagin* case reached the Ninth Circuit. *Smagin v. Yegiazarian*, 37 F. 4th 562, 567-68 (9th Cir. 2022). Smagin, a resident and citizen of Russia, had won an $84 million arbitral award in London against Yegiazaryan for fraudulent misappropriation in a real estate venture in Moscow. To avoid a Russian criminal indictment, Yegiazaryan fled to California. Smagin obtained a judgment in California recognizing the London award and brought a civil RICO action alleging an extensive pattern of racketeering activity to hide assets and frustrate enforcement of the California judgment.

The Ninth Circuit declined to follow the Seventh Circuit's residency-based approach, instead adopting a context-specific inquiry consistent with the Third Circuit in *GlaxoSmithKline*. *See id.* (some citations omitted). The Ninth Circuit concluded that Smagin sufficiently pleaded a domestic injury "because he had alleged that his efforts to execute on a California judgment

in California against a California resident were foiled by a pattern of racketeering activity that largely 'occurred in, or was targeted at, California' and was 'designed to subvert' enforcement of the judgment in California." *Smagin*, 143 S. Ct. at 1907 (citing *Smagin*, 37 F. 4th at 567-68 (9th Cir. 2022)).

The Supreme Court affirmed the Ninth Circuit's context-specific inquiry, holding that "determining whether a plaintiff has alleged a domestic injury [for purposes of RICO] is a context-specific inquiry that turns largely on the particular facts alleged in a complaint." *Id*. at 1909 (citation omitted). Under that approach, Smagin's allegations that his "interests in his California judgment against Yegiazaryan, a California resident, were directly injured by racketeering activity either taken in California or directed from California, with the aim and effect of subverting Smagin's rights to execute on [his] judgment in California . . . suffice to state a domestic injury." *Id*.

ROCKS IN THE WATER: NAVIGATING THE DAUNTING BURDENS OF CIVIL RICO TO ENFORCE FOREIGN ARBITRATION AWARDS

Smagin marks an important development in RICO jurisprudence – clarifying where a RICO injury is measured and opening the door to foreign plaintiffs to use this sharp tool to enforce awards and judgments they patriate to the United States. But domestic injury is just one of many requirements to state a private RICO claim and there are many reasons why, as the Southern District of New York observed, most such claims are doomed from the start. The pleading and proof requirements are exacting and beyond the reach of all but the most extreme cases. While courts have labored for decades to define the precise burdens a civil RICO plaintiff faces – even differing over the number of elements to be proven – the Second Circuit Court of Appeals recently provided a succinct statement likely to be cited frequently:

> For a RICO claim to survive, a plaintiff must adequately allege "the existence of seven constituent elements: (1) that the defendant[s] (2) through the commission of two or more acts (3) constituting a 'pattern'(4) of 'racketeering activity'(5) directly or indirectly invests in, or maintains an interest in, or participates in (6) an 'enterprise'(7) the activities of which affect interstate or foreign commerce."

MinedMap, Inc. v. Northway, 2022 U.S. App. LEXIS 5098, at *2 (2d Cir. Feb. 25, 2022) (citations omitted). Unpacking the burdens of each of these elements is beyond the aim of this article, but employing several best practices to evaluate claims before asserting RICO can help avoid the most common pitfalls.

The Single Operator Problem

Plaintiffs considering a civil RICO charge should carefully assess the nature and operation of the target defendant(s). RICO can be a tempting weapon in enforcement cases involving a heavy-handed operator of a debtor company, particularly where the owner/operator has deep pockets but has fleeced the debtor into insolvency. In such circumstances, however, without additional evidence of a broader enterprise, a valid RICO claim rarely lies and alter ego or fraudulent conveyance claims would be better suited to unwind the fleecing. RICO imposes a strict requirement to plead and prove a clear dichotomy between the defendant(s) and the enterprise. Courts consistently reject "the idea that a RICO enterprise may consist 'merely of a corporate defendant associated with its own employees or agents carrying on the regular affairs of the defendant.'" *Cruz v. FXDirectDealer, LLC,* 720 F.3d 115, 121 (2d Cir. 2013) (citations omitted). RICO claims should be reserved for instances where there is a clear "enterprise" distinct from the target defendants, through which the defendants operated.

The Problem with Mail Fraud and Wire Fraud

Before deciding to proceed with a RICO claim, Plaintiffs should carefully consider whether they have the evidence to plead and prove numerous predicate acts other than or in addition to mail fraud or wire fraud. 18 U.S.C. § 1961(1) enumerates a long list of potential predicate acts. The most common crimes alleged in civil cases, mail fraud and wire fraud, will invoke automatic elevated suspicion because of the risk that even ordinary business activity can be painted as fraudulent and conducted by mail or electronic means. As the Second Circuit described in *MinedMap*, "RICO claims premised on mail or wire fraud must be particularly scrutinized because of the relative ease with which a plaintiff may mold a RICO pattern from allegations that, upon closer scrutiny, do not support it." 2022 U.S. App. LEXIS at *2.

Some courts have taken this scrutiny further, creating an enhanced continuity requirement for cases invoking mail or wire fraud. *See, e.g., Feinstein v. Resolution Trust Corp.*, 942 F.2d 34, 46 (1st Cir. 1991) ("We hold

that, in assessing the longevity of a RICO scheme involving allegations of mail fraud, the scheme's duration must be measured by reference to the particular defendant's fraudulent activity, rather than by otherwise innocuous or routine mailings that may continue for a long period of time thereafter."). This requirement has been applied to require a plaintiff to establish a pattern and continuity with reference only to those communications independently comprising fraud, disregarding correspondence that may be part of an alleged scheme but are not independently fraudulent. *See, e.g., In re Am. Exp. Co. S'holder Litig.*, 840 F. Supp. 260, 264 (S.D.N.Y. 1993).

The Rule 9 Challenge

A plaintiff considering filing a RICO claim in the first litigation against a target defendant would be well advised to consider whether antecedent claims would better set up a proper assessment and assertion of RICO. In most civil RICO cases, the racketeering activity will sound in fraud, invoking the particularity requirement of Federal Rule of Civil Procedure 9(b), meaning allegations of predicate acts, pattern and continuity must be detailed with particularity. *See, e.g. Feinstein,* 942 F.2d at 42 ("It is settled law in this circuit that Fed.R.Civ.P. 9(b), which requires a party to plead fraud with particularity, extends to pleading predicate acts of mail and wire fraud under RICO.").

Meeting these requirements demands a more extensive level of pre-suit investigation and preparation than most other claims available to a plaintiff contemplating a civil RICO claim. In practice, asset recovery campaigns often require filing more than one case and the litigation leading to the underlying award or judgment can be a vital source of information to support the specificity required to conform to Rule 9 in the RICO context. This bar cannot be met with general allegations and averments on information and belief, but instead requires detailed knowledge about the enterprise and predicate acts that is often beyond the reach of investigation tools. In *Tatung*, we filed RICO claims only after several prior hard-fought cases yielded sufficient discovery to allege a highly-detailed description of the enterprise and its operations. Without the valuable discovery obtained in the antecedent cases, it is unlikely the case would have survived pre-trial motions, let alone provide the leverage to settle successfully during trial.

A New Sequencing Challenge

For foreign plaintiffs, the new path *Smagin* forged will likely prove narrow. To allege domestic injury, the plaintiff must plead – with specificity in most cases – that the pattern of racketeering was directed at and impacted U.S. enforcement rights. To meet this burden, the pattern will likely need to post-date a U.S. judgment recognizing and enforcing the award or foreign judgment or meaningfully continue after such a judgment is entered. This two-step process may require that a plaintiff holding a foreign judgment or award first patriate it to a U.S. judgment, then seek to enforce it under conventional post-judgment creditor rights. If those efforts are thwarted by a post-judgment pattern of racketeering, *Smagin* provides a path to civil RICO standing.

CONCLUSION

As the *Gross* survey of cases demonstrated, most civil RICO cases will not survive pre-trial motions, resulting instead in higher expenses and poorer outcomes than more readily established common law claims on the same facts. *See Gross*, 628 F. Supp. 2d at 480. For a creditor seeking to enforce a judgment or award against what appears on its face to be a RICO enterprise, successful and cost-effective enforcement requires diligence at the outset to decide whether asserting a civil RICO claim is likely to yield a better outcome or just drive up expenses. While such claims should be brought judiciously, in the right case, the reach and impact of electing the thermonuclear option can provide a much-needed sharp tool to pierce the most elaborate asset-protection schemes.

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