

711 F.2d 1343
 Fed. Sec. L. Rep. P 99,160
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United States Court of Appeals,
 Seventh Circuit.

James W. SCHACHT, the Acting Director of
 Insurance of the State of Illinois and
 Liquidator of Reserve Insurance Company,
 Plaintiff-Appellee,

v.

Isadore BROWN, et al., Defendants-Appellants.

Nos. 82-2088, 82-2089, 82-2090.

Argued Dec. 10, 1982.

Decided April 8, 1983.

As Amended on Denial of Rehearing and Rehearing
 En Banc July 1, 1983.


Certiorari Denied Nov. 28, 1983.

See 104 S.Ct. 508, 509.

State Director of Insurance, as liquidator of insurer, brought action to recover for alleged Racketeer Influenced and Corrupt Organizations Act violations by officers, directors, and parent corporation who allegedly continued insurer in business past the point of insolvency and looted insurer of its most profitable and least risky business. The United States District Court for the Northern District of Illinois, Thomas R. McMillen, J., denied defendants' motion to dismiss, and interlocutory appeal was allowed. The Court of Appeals, Harlington Wood, Jr., Circuit Judge, held that: (1) State Director had standing to maintain a civil action under RICO; (2) State Director's complaint sufficiently alleged a RICO violation; (3) it was not necessary that State Director's RICO complaint allege a competitive injury; and (4) State Director's complaint sufficiently alleged a causal nexus between RICO-proscribed conduct and insurer's damage to meet the requirements of RICO's civil damage provision.

Affirmed.

West Headnotes


[1] Insurance 1407
217k1407 Most Cited Cases
 (Formerly 217k72.7)

State Director of Insurance, as statutory liquidator of

insurer, had standing to maintain civil action under Racketeer Influenced and Corrupt Organizations Act against officers and directors of parent corporation, who allegedly fraudulently continued insurer in business past its point of insolvency and looted insurer of its most profitable and least risky business, aggravating the insolvency. 18 U.S.C.A. §§ 1961-1968.

[2] Commerce 80
83k80 Most Cited Cases

Complaint by State Director of Insurance, as statutory liquidator of insurer, sufficiently alleged a Racketeer Influenced and Corrupt Organizations Act violation by officers, directors and parent corporation, who allegedly fraudulently continued insurer in business past its point of insolvency and looted insurer of its most profitable and least risky businesses, aggravating the insolvency. 18 U.S.C.A. §§ 1961-1968, 1961, 1962(a, c).

[3] Commerce 80
83k80 Most Cited Cases

In order for State Director of Insurance, as statutory liquidator of insurer, to recover for alleged Racketeer Influenced and Corrupt Organizations Act violations by officers, directors and parent corporation who allegedly continued insurer in business past its point of insolvency and looted insurer of its most profitable and least risky business, it was not necessary that director allege a competitive injury. 18 U.S.C.A. §§ 1961-1968, 1962(c); Fed.Rules Civ.Proc.Rules 8(f), 12(b)(6), 28 U.S.C.A.

[4] Commerce 80
83k80 Most Cited Cases

Complaint by State Director of Insurance, as statutory liquidator of insurer, to recover for alleged Racketeer Influenced and Corrupt Organizations Act violations by officers, directors and parent corporation who allegedly fraudulently continued insurer in business past the point of insolvency and looted insurer of its most profitable and least risky business, sufficiently alleged a causal nexus between RICO-proscribed conduct and insurer's damage to meet the requirements of RICO's civil damage provision. 18 U.S.C.A. §§ 1961-1968, 1964(c).

*1344 Jerold S. Solovy, Donald R. Harris, Jayne W.

Barnard, Marguerite M. Thompkins, Jenner & Block, Sheldon Karon, Victor G. Savikas, Richard L. Horn, Dwight B. Palmer, Karon, Morrison & Savikas, Ltd., Chicago, Illinois, for Individual defendants.

Ronald A. Jacks, James B. Burns, David M. Spector, Steven R. Gilford, Edward R. Gower, Isham, Lincoln & Beale, Chicago, Illinois for SCOR and SCOR RE.

Charles W. Boand, Robert F. Forrer, Quinton F. Seamons, Dennis J. O'Hara, Wilson & McIlvaine, Chicago, Illinois, for Arthur Andersen & Co.

Powell Pierpoint, Jay Kelly Wright, John V. Geise, Hughes Hubbard & Reed, New York City and Robert G. Schloerb, John W. McCullough, Richard T. Greenberg, F. Dennis Nelson, Peterson, Ross, Schloerb & Seidel, Chicago, Illinois, for Coopers & Lybrand.

William Bruce Hoff, Jr., Stanley J. Parzen, Richard A. Salomon, Hope G. Nightingale, Mayer, Brown & Platt, Chicago, Illinois, for Alexander Grant & Co.

Raymond J. Smith, Burke & Smith, Ellen G. Robinson, Chicago, Ill., for plaintiff-appellee.

Before CUMMINGS, Chief Judge, WOOD, Circuit Judge, and HOFFMAN, Senior District Judge. [FN*]

FN* The Honorable Walter Hoffman, Senior District Judge of the Eastern District of Virginia, is sitting by designation.

HARLINGTON WOOD, Jr., Circuit Judge.

This is an interlocutory appeal from the district court's order denying defendants' motion to dismiss the complaint; it was certified to this court for resolution of controlling questions of law, pursuant to 28 U.S.C. § 1292(b). While the district court did not limit its certification to a particular question, it stated that it viewed the "controlling question" to be whether the plaintiff may sue for the type of injury he alleges here under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961- 1968 (hereinafter, RICO). In order to reach this jurisdictional issue, however, we find it first necessary to determine the standing of the plaintiff, the Director of Insurance of the State of Illinois (Director), who is the statutory liquidator of Reserve Insurance Company (Reserve), to maintain *1345 the action, and to

determine the sufficiency of the complaint. We conclude that the Director has standing, that his complaint is sufficient, and that it alleges an injury which may be redressed by a civil action under RICO.

I. *Factual Background*

Although the alleged events giving rise to this action are complex, they may be outlined briefly for the purposes of this appeal. The main focus of the allegations is that, as a result of the fraudulent actions of the various defendants, Reserve's corporate parent was caused to continue Reserve in business even though the latter was insolvent, and was caused to saddle Reserve with additional liabilities and drive it deeper into insolvency, all of which consequences resulted in damage to Reserve, as well as its policyholders and creditors, exceeding \$100,000,000.

The complaint recites that, as of December 31, 1974, Reserve was insolvent as a result of its policy of accepting extraordinarily high-risk insurance business and underreserving and maintaining insufficient surplus for potential claims. In late 1974, the Director alleges, the Illinois Department of Insurance became concerned about the diminution of Reserve's surplus, and initiated negotiations with the officers and directors of Reserve and American Reserve Corporation (ARC), Reserve's corporate parent, to rectify the problem. While these negotiations were proceeding, however, the officers and directors of Reserve and ARC caused their companies to enter into an agreement with defendants Societe Commerciale De Reassurance (SCOR), a deal brokered by SCOR Reinsurance Company (SCOR Re).

Under the terms of this agreement, Reserve ceded to SCOR most of its more profitable and least risky business (in return for SCOR's payments of commissions to Reserve), most of which business SCOR in turn secretly retroceded to another ARC subsidiary, Guarantee Reserve Co., Ltd. (GRC). Also, because the capitalization of GRC was insufficient to cover the potential losses involved in this retrocession, the Director alleges, ARC's officers and Directors secretly agreed to guarantee GRC's obligations to SCOR. The purpose of these agreements, the Director charges, was to enable Reserve to report on paper a smaller volume of business and an increase in surplus and thus a lower liability-to-surplus ratio, a fraudulent result which concealed and exacerbated Reserve's actual insolvency.

By concealing Reserve's continued liability for the retroceded business and hence Reserve's continued insolvency, the Director alleges, the defendant directors and officers were able to fraudulently obtain approval

of the Illinois Department of Insurance for the cession agreements and were able to reach a consent agreement with the Department in April, 1975 which enabled Reserve to continue operations if certain surplus requirements were met. In addition, the subsequent continuation of these concealments effected through the SCOR agreements enabled Reserve's officers to violate the explicit surplus maintenance requirements of the consent agreement, the Director avers, while the SCOR agreements had the further cumulative effect of draining away from Reserve its more profitable and less risky business and over \$3,000,000 in income. If the Department had at any time known of Reserve's actual insolvency, the complaint charges, it would not have permitted Reserve to continue to write insurance and suffer further dissipation of its assets, but would have caused Reserve to stop writing insurance pursuant to Ill.Rev.Stat., ch. 73, § 756.1 (1981). The complaint alleges that defendants SCOR and SCOR Re were aware of the fraudulent purposes (and the further crippling impact upon Reserve) of the underlying agreements which they entered into and brokered. The director further alleges that the defendant accounting firms, Coopers and Lybrand, Alexander Grant and Co., and Arthur Andersen and Co., knew of Reserve's insolvency and of the further impairing effect of the SCOR agreements and Reserve's continued operations, but that, despite this knowledge, each of them prepared unqualified opinion letters as to ARC's consolidated financial statements in 1974, 1975, 1976 and 1977, even though those statements failed to disclose that the SCOR agreement was entered into to conceal Reserve's insolvency, that the SCOR agreement did not remove any substantial risk of loss from Reserve and ARC, that the SCOR arrangement had been used to evade the consent agreement, that Reserve was at all times insolvent, and that the SCOR arrangement resulted in the multiplication of Reserve's high risk business while draining it of its least risky and most profitable business. In short, the Director claims that SCOR, SCOR Re and the accounting firm defendants joined with ARC and Reserve's officers and directors in *1346 a multifaceted, fraudulent scheme which kept Reserve operating long past insolvency in a manner which resulted in enormous losses to the latter company.

In 1979, Reserve was finally adjudicated insolvent and the Director was designated as the Liquidator of Reserve pursuant to Ill.Rev.Stat., ch. 73, §§ 799 *et seq.* (1981). Under that statute, the Director is vested with all rights of action belonging to Reserve. Ill.Rev.Stat., ch. 73, § 805 (1981). Pursuant to that mandate, the Director filed this action in district court in 1981, seeking relief for damages sustained by Reserve as a

result of the alleged fraudulent scheme under RICO and a variety of Illinois statutory and common law theories. In January, 1982, the district court granted the defendants' motion to dismiss fifteen pendant state law claims, but denied their motion to dismiss Counts II and IV, seeking relief under RICO, and Counts I and III, alleging and seeking relief for damages resulting from a criminal conspiracy under Illinois law.

After discovery had commenced, the district court denied defendants' motion to reconsider, but certified its order to this court for an interlocutory appeal; we thereafter granted defendants' petition for interlocutory appeal. The defendants' chief contention on appeal is that the district court lacks jurisdiction over the present matter because Reserve's injuries as alleged in Count II and Count IV of the Director's complaint are not actionable under RICO's civil damage provision, 18 U.S.C. § 1964(c), but some of the defendants also argue that, even assuming that RICO applies, the Director still lacks standing to maintain the present action, and that in any event the Director's complaint insufficiently invokes the formal elements of a RICO claim. We first address the defendant's standing arguments, and then consider defendants' RICO-related contentions.

II. *The Director's Standing: Capacity and Equitable Estoppel*

RICO considerations aside, defendants Grant, Coopers and Lybrand, Arthur Andersen, and SCOR and SCOR Re argue that the Director either lacks standing *ab initio* to maintain the present action or is estopped from doing so. [FN1] Their main argument proceeds in two stages. First, they note, the Director as Liquidator acquires only those rights of action that would accrue to Reserve itself; the Director may not assert the legal claims of Reserve's policyholders or creditors. As the next step, they argue that since the Director admits that Reserve's officers and directors instigated the illegal conduct here, the Director, standing in the shoes of Reserve, is estopped [FN2] from proceeding against the extra-corporate confederate defendants under our decision in *Cenco, Inc. v. Seidman & Seidman*, 686 F.2d 449 (7th Cir.1982). SCOR and SCOR Re argue additionally that, *Cenco* considerations aside, prevailing law does not permit an insurance liquidator to pursue on behalf of the corporation he represents claims for losses stemming from the artificially and fraudulently prolonged life of the corporation and its consequent dissipation of assets.

[FN1]. The other defendants, directors and

officers of Reserve and ARC, do not challenge in their brief on appeal the Director's right to proceed against them on any basis other than RICO.

FN2. Some defendants have also characterized this procedural bar as a substantive one, arguing that the complaint must fail because its facts demonstrate that the Director will be unable to demonstrate *causation* of fraud, given the corporation's imputed knowledge. Because both characterizations raise the same issue, both will be dealt with under the "estoppel" heading.

[1] Even accepting the first step of the defendants' argument, [FN3] *i.e.*, that the Director *1347 may prosecute only those legal actions available to the corporate body, we disagree with the defendants' contention that *Cenco* applies to the instant case, or that, even if it does apply, its underlying policy forbids the Director from maintaining the present action on behalf of Reserve. In addition, we reject SCOR and SCOR Re's fallback position that Reserve lacks standing to sue, either derivatively or through a receiver, to recover damages resulting from the fraudulently extended life of the corporation and its concomitant dissipation of assets.

FN3. Although we need not reach the question for the purpose of this appeal, we note our agreement with the proposition that the Director may pursue no action which could not have been asserted directly by Reserve before liquidation. This conclusion is supported first by the plain text of the statute which provides that the Director as Liquidator "shall be vested by operation of law with the title to all property, contracts and *rights of action of the company* as of the date of the order ... directing liquidation." Ill.Rev.Stat., ch. 73, § 803 (emphasis added). Second, a century of interpretation of this and its predecessor provisions has established the basic rule that "where a receiver is appointed for the purpose of taking charge of the property and assets of a corporation, he is, for the purpose of determining the nature and extent of his title, regarded as representing only the corporate body itself, and not its creditors or shareholders.... [H]e takes only

the rights of the corporation such as could be asserted in its own name, and that upon that basis, only, can he litigate for the benefit of other shareholders or creditors." Republic Life Insurance Co. v. Swigert, 135 Ill. 150, 167, 25 N.E. 680 (1890); People ex rel. Barret v. Bank of Peoria, 295 Ill.App. 543, 549, 15 N.E.2d 333, 335-36 (1938); Sangamon Loan & Trust Co. v. People's Savings Bank & Trust Co., 204 Ill.App. 7, 14 (1917); Golden v. Cervenka, 278 Ill. 409, 437, 116 N.E. 273, 284 (1917); *see also* 19 Appleman, Insurance Law and Practice, § 10682 at 122, 123 (1982); 2 Couch on Insurance 2d, § 22:48 (1959). A narrow exception to this rule has been permitted where, unlike here, the receiver sues to recover on behalf of a plaintiff's creditors a specific asset from a defendant who has, with the knowledge of the plaintiff's corporate officials, misrepresented its existence. Sangamon, 204 Ill.App. at 14; Golden, 278 Ill. at 427; *see also* Wheeler v. American National Bank, 347 S.W.2d 918, 925 (Tex.1961); Magnusson v. American Allied Insurance Co., 290 Minn. 465, 189 N.W.2d 28, 33 (1971). Bonhiver v. Graff, 311 Minn. 111, 248 N.W.2d 291 (1976) and McTamany v. Day, 23 Idaho 95, 128 P. 563 (1912), cited by the Director, are distinguishable. The statute involved in Bonhiver, Minn.Stat. Ann. § 60B.25(13), authorized the liquidator to assert claims of creditors and policyholders, while in McTamany, the court held only that the receiver could proceed on behalf of creditors and policyholders against the insolvent company's directors, not extracorporate parties. McTamany, 128 P. at 565. In any event, to the extent that either of these cases can be read to authorize an insurance liquidator to pursue claims more extensive than those accruing to the corporation itself, they conflict with the clear rule fashioned by the Illinois courts and the leading authorities. It is therefore incumbent upon this court not to effect innovation in what appears to be settled state law. Murphy v. White Hen Pantry Co., 691 F.2d 350, 355 (7th Cir.1982).

Our reasons for finding *Cenco* inapplicable to the estoppel issue in the present case are twofold. First, the main controverted claim in *Cenco* arose under Illinois common law, and therefore this court's analysis

of circumstances under which the knowledge of fraud on the part of the plaintiff's directors be imputed to the plaintiff corporation were merely an attempt to divine how Illinois courts would decide that issue. Cenco, 868 F.2d at 455. By contrast, the cause of action here arises under RICO, a federal statute; we therefore write on a clean slate and may bring to bear federal policies in deciding the estoppel question.

Second, even if the estoppel holding in *Cenco* were relevant to a RICO claim, an important prerequisite for its invocation in the present case is lacking. The *Cenco* court limited its estoppel analysis to cases where "the managers are not stealing from the company ... but instead are turning the company into an engine of theft against outsiders." Cenco, 686 F.2d at 454. As the court explained,

Fraud on behalf of a corporation is not the same theory as fraud against it. Fraud against the corporation usually hurts just the corporation; the stockholders are the principal if not only victims.... But the stockholders of a corporation whose officers commit fraud for the benefit of the corporation are beneficiaries of the fraud.

Id. at 456. In *Cenco*, this court found that the fraudulent inflation of the corporation's inventories and hence stock prices clearly benefited the corporation to the detriment of outside creditors, stock purchasers and insurers; this fact, in the court's view, made the case ripe for an analysis of whether the directors' knowledge of the fraud should be imputed to the benefited corporation. By contrast, the complaint in the instant case alleges a far-reaching scheme in which, as a consequence of the illegal activities of Reserve's directors and the outside defendants, Reserve was, *inter alia*, *1348 fraudulently continued in business past its point of insolvency and systematically looted of its most profitable and least risky business and more than \$3,000,000 in income--all actions which aggravated Reserve's insolvency. In no way can these results be described as beneficial to Reserve. [FN4] Compare *Security America Corp. v. Schacht*, No. 82-C-2132, slip op. at 3, 4 (N.D.Ill. Jan. 31, 1983) ("particular fact pattern" established that plaintiff corporation had been created solely to carry out fraudulent scheme and thus had no other purpose than to be "engine of theft" against outsiders under *Cenco*).

FN4. These defendants argue that, since Reserve was a wholly-owned subsidiary of ARC, the owners of Reserve, i.e. ARC shareholders, automatically benefited from the direct draining of Reserve and the fraudulent

prolongation of Reserve's life. This argument founders on both logic and fact. First, it defies common sense to suggest that a parent corporation's shareholders are not injured when their directors fraudulently prop up, drain, and thereby deepen the insolvency of a subsidiary for whose liabilities the shareholders will eventually be liable. The damage resulting to the parent corporation's shareholders is as real as if the management had impaired a valuable working asset or sold it for a meager sum far less than its present value. Second, as a factual matter, the complaint alleges that not all of the proceeds resulting from the crippling of Reserve redounded to the benefit of ARC and ARC's shareholders. According to the allegations, as a result of the SCOR agreements, ARC was secretly exposed to increased liability for GRC's performance; also as part of these agreements, SCOR allegedly received additional payments from ARC in excess of \$2,500,000 for its assistance in furthering the scheme.

Defendants argue nonetheless that since the alleged fraudulent scheme had the effect of continuing Reserve's active corporate existence past the point of insolvency to the detriment of outside creditors and policyholders, Reserve was *pro tanto* benefited. But the fact that Reserve's existence may have been artificially prolonged pales in comparison with the real damage allegedly inflicted by the diminution of its assets and income. Under such circumstances, the prolonged artificial insolvency of Reserve benefited only Reserve's managers and the other alleged conspirators, not the corporation. See *In re Investor's Funding Corp.*, [1980] Fed. Sec. L. Rep. (CCH) ¶97,696 at 98,655 (1980). More colloquially put, if defendants' position were accepted, the possession of such "friends" as Reserve had would certainly obviate the need for enemies. We do not believe that such a Pyrrhic "benefit" to Reserve is sufficient to even trigger the *Cenco* analysis which seeks to determine the propriety of imputing to the corporation the directors' knowledge of fraud.

Even if a *Cenco* -type analysis were applied to the instant case, however, it would not yield the result that defendants urge, i.e., estoppel of the Director based on the imputation to Reserve of the directors' knowledge of fraud. In *Cenco*, we undertook a two-pronged analysis to determine whether such imputation should occur: whether a judgment in favor of the plaintiff

