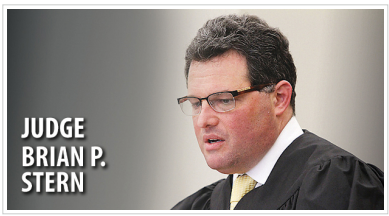
RHODE ISLAND LAWYERS WEEKLY

RICO claims premised on usurious loans dismissed

Other counts survive against attorney, firm

By: Barry Bridges October 24, 2019



A Superior Court judge has dismissed RICO claims brought by a plaintiff receiver against several defendants, including an attorney, his law firm, and a Florida limited liability company, finding insufficient allegations of the requisite RICO "enterprise" or pattern of racketeering activity.

However, the question of whether the defendants engaged in the conduct underlying the purported RICO violations — the collection of usurious debt — was among the counts that survived the motions to dismiss weighed by Judge Brian P. Stern.

In 2018, Richard L. Gemma, the receiver for BR Asset Management, LLC, formerly known as Benrus, filed a multi-count action against the company's former lawyer, Michael F. Sweeney, and his Providence law firm, Duffy & Sweeney. Anchoring the suit was BRAM's contention that loans extended to BRAM by the defendants to cover the production costs of its consumer products were at an interest rate exceeding the maximum allowed in Rhode Island, 21 percent per year.

BRAM also cited RICO violations based on those alleged usurious transactions.

In considering the defendants' ensuing motions to dismiss, Stern determined that the usury counts could proceed, but dismissed the RICO claims in their entirety.

"Plaintiff has alleged defendants made three advances to the same debtor to fund the debtor's backpack production, watch production, and shipping and delivery costs," the judge wrote. "Faced with no allegations of a pattern, a description of a usurious loan, and threadbare allegations of a structure, this court must intervene to prevent the simple practice of usury from becoming the logical equivalent of RICO based on the collection of an unlawful debt."

Max R. Wistow of Providence was counsel for the receiver. Representing the various defendants were John B. Daukas of Boston, and William M. Dolan and W. Mark Russo, both of Providence. Wistow and Dolan declined to comment on the decision; Daukas and Russo did not respond by press time.

Lending transactions

Plaintiff BRAM was a retailer that designed and sold products such as watches and backpacks. Defendants Sweeney and his law firm, Duffy & Sweeney, served as the company's legal counsel at times relevant to the complaint.

In April 2016, BRAM was projecting $1 million in sales but lacked the cash flow to pay for the related production costs. Aware of the company's financial situation, Sweeney and D&S reached a financing agreement to extend $499,621 to BRAM to fund the production of its backpacks.

CASE: *Gemma v. Sweeney, et al.*, Lawyers Weekly 61-115-19 (31 pages)

COURT: Superior Court

ISSUE: Did a plaintiff put forth sufficient facts to withstand the defendants' motions to dismiss RICO claims predicated on the alleged collection of usurious debt?

DECISION: No

Accordingly, on April 22, a partial advance of $149,886 was made to BRAM. On the same date, Sweeney also filed with the Florida secretary of state articles of organization for an LLC, PalmLake, of which he and another defendant, Barry Gertz, are members.

The next day — after having already advanced funds — BRAM and Sweeney executed an agreement under which PalmLake purchased BRAM's backpack purchase orders for a total price of $499,621. The contract provided for an initial advance of $149,886, a "fee" to PalmLake equal to 15 percent of the advances within 90 days, and a Florida choice-of-law provision.

On May 5, Sweeney personally conveyed another $22,500 to BRAM to fund the production of watches. They entered into a supplemental financing agreement reflecting that additional advance, and, like the purchase agreement, it contained a Florida choice-of-law provision and specified a 15 percent fee to PalmLake.

On May 20, the balance of the original purchase price was purportedly advanced.

And in June, Sweeney and Gertz wired another $77,553 to BRAM to cover shipping and delivery costs. A second supplemental financing agreement was executed with terms similar to the first.

Beginning in July, Sweeney and D&S began to collect payments from BRAM's account debtors and deposited them into a client trust account for BRAM. D&S then distributed those funds directly to defendants Sweeney and Gertz individually, not to PalmLake.

BRAM filed suit in May 2018, alleging that Sweeney, D&S, Gertz and PalmLake engaged in fraudulent lending transactions violative of state usury laws and RICO.

In its pleadings, BRAM said that "[d]efendants Sweeney and Gertz, purportedly on behalf of PalmLake (but in fact on behalf of Sweeney and Gertz) advanced a total of $599,674.14 in funds toward BRAM's production and shipping costs" and that the company repaid a total of $689,625.26, plus additional $4,000 "legal fees."

The defendants moved to dismiss the various counts under Superior Court Civil Rule 12(b)(6).

Usury claims

Stern first determined that the usury counts could move forward, whether analyzed under Rhode Island or Florida law.

In light of the principle that a court at the pleadings stage is required to assume the truth of even facts made with "great generality," Stern was reluctant to dispose of the claim against Gertz. The judge noted that BRAM repeatedly alleged in its filings that Gertz, in his individual capacity, had loaned money at usurious interest rates, notwithstanding that the lending documents identified PalmLake as the supposed financier.

"Plaintiff has alleged such documentation 'did not accurately reflect the true arrangement between the parties and was intended to disguise a usurious transaction,'" Stern wrote. "Determining which parties extended credit and in what capacity is a fact-based inquiry not appropriate for resolution on a motion to dismiss."

In a similar vein, the usury claim could proceed against D&S, Stern ruled, as the court could not discern the parties' respective roles without drawing impermissible inferences against the plaintiff.

The calculus as to Sweeney rested on different considerations, however. In moving for dismissal, he argued that suit in Rhode Island was precluded by the Florida choice-of-law provision in the subject agreements.

BRAM responded that the choice-of-law language was unenforceable because PalmLake, a Florida company, was organized for the "sole purpose of evading Rhode Island law and [was] never treated as a separate legal entity."

Stern stressed that parties must act in good faith when exercising their power to select the jurisdiction whose law they intend to control their contracts.

"Rhode Island law places certain limitation on a party's right to have a contract enforced in accordance with the law of his or her choosing," Stern wrote. "Furthermore, the parties may not contrive or create fictitious contact with an otherwise non-interested jurisdiction to validate a choice-of-law provision."

Denying Sweeney's motion, the judge explained that if plaintiff BRAM could establish sufficient facts to support its theory that the individual defendants organized PalmLake solely to avoid Rhode Island law, and that PalmLake itself played no substantial role in the underlying financing transactions, BRAM might be able to successfully argue the parties selected Florida law in bad faith and created a "fictitious connection" with the state, rendering the choice-of-law provision unenforceable.

Further, Stern held that BRAM alleged a viable basis for piercing the corporate veil against Sweeney and Gertz with its claims that they had organized PalmLake for the purpose of evading Rhode Island's interest and usury laws.

"Rhode Island's usury laws are intended to protect Rhode Island debtors; an intent to evade these laws may support a basis for veil piercing," Stern wrote. "In addition to plaintiff's allegations regarding defendants' impermissible intent, the court is troubled by the complaint's allegations that 'substantially all funds' were distributed directly to PalmLake's members, leaving PalmLake itself, for all intents and purposes, an undercapitalized empty shell: these allegations alone support piercing."

However, the same result did not apply to D&S as ownership interest is a prerequisite to attaching alter-ego liability. BRAM did not allege that the firm had such an interest in PalmLake.

No RICO 'enterprise'

The plaintiff's RICO claims, based on the defendants' alleged collection of usurious debt, did not fare as well, with Stern concluding that BRAM failed to sufficiently allege the existence of an "enterprise" necessary under the statute.

The case against PalmLake and D&S failed on the "distinctiveness" requirement.
"Both PalmLake and D&S are clearly legal entities, which would appear to satisfy the enterprise element," Stern wrote. "However, to establish liability … one must allege … the existence of two distinct entities: (1) a 'person'; and (2) an 'enterprise' that is not simply the same 'person' referred to by a different name."

The rationale for RICO's distinctiveness mandate, Stern added, is that "one speaks of employing, being employed by, or associating with others, not oneself."

The judge faulted the plaintiff for convoluting the parties' respective roles by alleging that all defendants are RICO "persons" who engaged in usury.

"[B]ecause plaintiff has treated defendants as a 'single, undifferentiated mass' at various times throughout the complaint, the court has been unable to assess when, where, and how defendants participated in the allegedly illegal collection practices to consider whether the allegations satisfy the distinctiveness requirement," Stern concluded.

Further, the plaintiff's argument that Sweeney and Gertz made up an "association-in-fact" enterprise was also deficient, as the required structural features — a purpose, relationships among those associated with the enterprise, and longevity sufficient to permit the associates to pursue the enterprise's purpose — were not demonstrated, the judge found.

Stern's review of the complaint indicated that it contained no factual allegations relating to the rules, routines, or processes through which the purported Sweeney-Gertz enterprise maintained operations.

The court "cannot countenance the transmogrification of garden-variety usury allegations into RICO allegations, which, by their very pendency, can be stigmatizing and costly," Stern said.

Issue: OCT. 28 2019 ISSUE

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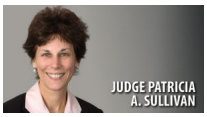

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40 Court Street, 5th Floor,

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