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July 1, 2009 | Commercial Litigation (http://www.rmfpc.com/publications/articles/commercial-litigation-articles/)

Civil RICO and Equitable Tolling: Plaintiff Who Hesitates Is Lost

by Stephen E. Kesselman

In a significant U.S. Supreme Court decision regarding the statute of limitations in civil RICO actions, the Court in 2000 held in *Rotella v. Wood* that the four-year statute of limitations period begins as soon as a plaintiff discovers his injury, regardless of when the fraud causing that injury is discovered.

Prior to *Rotella*, some appellate and district courts had held that the RICO statute of limitations did not commence to run until the plaintiff discovered both an injury and a pattern of RICO activity. Hence, *Rotella* requires a plaintiff to move with more diligence in asserting RICO claims.

Some plaintiffs who have commenced otherwise time-barred claims have attempted to rely on a single sentence of the *Rotella* decision concerning the doctrine of "equitable tolling" (sometimes referred to by other courts as "fraudulent concealment'), in an effort to save their claims from dismissal.

The *Rotella* Court held:

In rejecting pattern discovery as a basic rule, we do not unsettle the understanding that federal statutes of limitations are generally subject to equitable principles of tolling, and where a pattern remains obscure in the face of a plaintiff's diligence in seeking to identify it, equitable tolling may be one answer to the plaintiff's difficulty.

Plaintiffs attempting to rely on this sentence of *Rotella* to, in essence, limit substantially the *Rotella* holding, typically ignore the very next sentence of the decision: "The virtue of relying on equitable tolling lies in the very nature of such tolling as the exception, not the rule.'

This article discusses the cases that have followed in the wake of *Rotella* and which serve to highlight the critical importance for a RICO plaintiff to move with diligence in asserting claims and not to rely on equitable tolling to save time-barred claims.

The three elements for demonstrating a successful claim of "equitable tolling" in a civil RICO action are well established and were set forth by the U.S. Court of Appeals in the Second Circuit in *Tho Dinh Tran v. Alphonse Hotel Corp.*

Under federal common law, a statute of limitations may be tolled due to the defendant's fraudulent concealment if the plaintiff establishes that: (1) the defendant wrongfully concealed material facts relating to defendant's wrongdoing; (2) the concealment prevented plaintiff's 'discovery of the nature of the claim within the limitations period'; and (3) the plaintiff exercised due diligence in pursuing the discovery of the claim during the period plaintiff seeks to have tolled.

Holding that the investor plaintiffs in connection with an alleged tax shelter fraud scheme could not demonstrate the second two of the "equitable tolling" elements (i.e., plaintiffs' lack of knowledge of the nature of claim and plaintiff's lack of due diligence), Judge Leonard Sand in *131 Main St. v. Manko*, granted summary judgment and dismissed plaintiffs' claims as time- barred.

Plaintiffs in *131 Main St.* were investors in one or more limited partnerships formed in 1977 to allow investors to obtain tax-advantaged investments, usually through some form of income deferral. Beginning in 1982, defendants allegedly entered the partnerships into prearranged and fraudulent repurchase transactions with an inactive corporation controlled by the general partners to finance certain trades in U.S. government-backed securities.

From the beginning of the investment partnerships through February 1988, the limited partner investors retained certain accountants as "watchdogs" or "snoops" to monitor the investments and defendants' operations. On Feb. 8, 1989, the general partners were indicted for tax fraud and other charges and plaintiffs' action was not commenced until precisely four years after that indictment.

Equitable Tolling Rejected

Judge Sand held that plaintiffs' claims were barred by the statute of limitations under *Rotella* and rejected plaintiffs' attempt to invoke the principles of "equitable tolling.'

Specifically, Judge Sand found that since the plaintiffs began in 1985 to receive annual IRS notices of disallowance that challenged repeatedly the bona fides of the investments and because their "watchdog" suspected wrongdoing by the partnerships, plaintiffs could not satisfy the requirement that they were ignorant of their causes of action.

In addition, Judge Sand found that by not replacing their "watchdog" after his resignation, the plaintiffs had failed to act with the required diligence.

Judge Harold Baer reached a similar result in *DLT Resources, Inc. v. Credit Lyonnais Rouse, Ltd.* In that case, Judge Baer held plaintiff's civil RICO action commenced in 2000 as time-barred and denied the application of what he referred to as the doctrine of "fraudulent concealment" to save those claims.

Plaintiff, a copper trading business, alleged that it was defrauded by defendant and disloyal employees during 1990 and 1991. Specifically, plaintiff alleged that "it did not know, nor with reasonable diligence could have known that defendant was a participant in the fraudulent scheme at the time it suffered an injury" and claimed it did not learn until 1998 about defendant's participation in the 1990 and 1991 conduct and thus attempted to rely on the doctrine of "fraudulent concealment.'

However, Judge Baer found that a 1992 letter plaintiff had written to a British regulatory agency that contained allegations which largely mirrored some of the claims asserted in the RICO action demonstrated that plaintiff knew some of the critical facts that formed the basis for its claims, even if it did not know the full extent of the participation of defendant in the scheme.

Judge Baer held that "it was incumbent upon plaintiff to consult a lawyer after he became aware of the alleged conspiracy between [defendant] and the employees [of plaintiff] to determine whether he had been wronged, and whether he should commence litigation." But see *In re Sumitomo Copper Litigation.*

Other Cases

Other Circuit courts have denied the application of the "equitable tolling" or "fraudulent concealment" doctrine and have dismissed time-barred civil RICO actions.

For example, in *Matthews v. Kidder Peabody & Co., Inc.*, the Third Circuit affirmed and held that investors' RICO claims were time-barred and that the doctrine of "fraudulent concealment" was inapplicable where the investors failed to diligently investigate "storm warnings" contained in financial updates informing the investors that their quarterly distributions from certain securities funds had decreased dramatically and that they were thus placed on "inquiry notice" that the securities were misrepresented by defendant as low- risk vehicles similar to municipal bonds.

In *Pincay v. Andrews*, the Ninth Circuit reversed the district court's denial of a motion for judgment as a matter of law following a jury verdict. The court held that the civil RICO claims against investment advisors for purportedly receiving fees in excess of what was permitted were time-barred where the investors did not bring their action until 1989, even though they received written disclosure of the alleged fraud in 1980, thus providing them with constructive knowledge of the predicate acts of fraud.

So also, in *Pacific Harbor Capital, Inc. v. Barnett Bank*, the Eleventh Circuit affirmed summary judgment dismissing as time-barred a lender's civil RICO claims against its disbursing agent in connection with a real estate development. The court found that the lender could not successfully invoke the "equitable tolling" doctrine and claim it only learned of the full nature of the alleged fraud after certain participants pled guilty to federal crimes.

Rather, the court held the lender showed insufficient diligence in investigating the facts that would have led to information about the disbursing agent in a prior lawsuit against the developer and the bank's law firm.

The circuit explained:

The financial fraud victim is … not allowed to wait for time, the mother of truth, to make manifest a prohibited pattern. True, fraud by its nature means that the truth has been concealed. But the 'occurrence of fraud in RICO patterns' is not a good reason to put off the running of the statute.

Accordingly, plaintiffs in civil RICO claims cannot wait for all of the pieces of suspected fraud to be revealed or wait for a prosecutor to do the work that a diligent plaintiff is required to do.

Instead, the post-*Rotella* decisions discussed herein show that such a plaintiff will have its civil RICO claims dismissed and cannot count on the equitable tolling doctrine to save such claims.

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