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Supreme Court Allows Arbitration-Related RICO Claim to Proceed

An Arbitral Award Creditor May Be Entitled to RICO's Treble Damages Where an Award Debtor Attempts to Evade Enforcement of an Arbitral Award

SUMMARY

On June 22, 2023, the Supreme Court ruled 6-3 that a debtor's actions to evade paying a \$92 million U.S. judgment that enforced an unpaid arbitral award could result in a "domestic injury" under the RICO Act. The ruling resolved a previous circuit split. The Seventh Circuit had required the injured party to reside in the U.S. to satisfy the "domestic injury" requirement, whereas the Ninth and other circuits assessed whether a "domestic injury" had occurred based on a more holistic context-based inquiry. The Supreme Court agreed with the Ninth Circuit, and adopted the "context-specific" inquiry. It ruled that the plaintiff had sufficiently pled a "domestic injury" because the rights to enforcement of the arbitral award had crystallized in the United States, and the alleged racketeering activity had been largely undertaken in the United States.

BACKGROUND

18 U.S.C. § 1964 (the Racketeer Influenced and Corrupt Organizations Act ("RICO")) gives a private cause of action to "[a]ny person injured in his business or property by reason of a violation of" the statute's substantive provisions.¹ Satisfying a civil RICO claim requires the following elements: "(1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity (known as 'predicate acts') (5) causing injury to the plaintiff's 'business or property.'"² The "predicate acts" must be a crime referred to in the statute's definition of "racketeering activity."³ The Supreme Court has also previously held that the "injury" must be a "domestic injury."⁴ A successful RICO claim can lead to an award of damages three times the amount of actual damages caused by the racketeering activity.⁵

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In 2014, following an LCIA arbitration proceeding seated in London and governed by English law,⁶ Vitaly Smagin (a non-U.S. national who lives in Russia) won an award against Ashot Yegiazaryan (a non-U.S. national who lives in California) for over \$84 million.⁷ Smagin subsequently sought to enforce the award in California, and the Central District Court in California issued a temporary protective order and then permanent injunction freezing Yegiazaryan's California assets.⁸ In 2016, the Court ruled in Smagin's favor and entered a \$92 million dollar judgment (including interest) against Yegiazaryan.⁹

Meanwhile, in May 2015, Yegiazaryan himself received \$198 million from an unrelated arbitration.¹⁰ Smagin alleged that Yegiazaryan "accepted the money through the London office of an American law firm headquartered in Los Angeles."¹¹ Smagin alleged Yegiazaryan then "created 'a complex web of offshore entities to conceal the funds,'" and "ultimately transferred the funds to a bank account with petitioner CMB Monaco."¹² Yegiazaryan allegedly "also directed those in his inner circle to file fraudulent claims against him in foreign jurisdictions, which he would not oppose, in an attempt to obtain sham judgments that would encumber the \$198 million, thereby blocking Smagin's access to it."¹³

In 2020, Smagin filed a civil RICO lawsuit against, among others, Yegiazaryan and CMB Bank. At a high level, Smagin alleged "that the defendants worked together under Yegiazaryan's direction to frustrate Smagin's collection on the California judgment through a pattern of wire fraud and other RICO predicate racketeering acts, including witness tampering and obstruction of justice."¹⁴ The lawsuit sought actual damages of "no less than \$130 million" as well as attorneys' fees and treble damages.¹⁵

The District Court dismissed the complaint, reasoning that Smagin did not "adequately plead a domestic injury," because Smagin was a resident and citizen of Russia and therefore experienced his injury in Russia.¹⁶ The Ninth Circuit reversed, rejecting this "rigid, residency-based test" for a "context-specific" approach.¹⁷

THE SUPREME COURT'S DECISION

The Supreme Court affirmed, holding that courts should apply a "context-specific inquiry" to determine whether a complaint alleged a domestic injury for RICO purposes. While cautioning that no specific "set of factors can capture the relevant considerations for all cases,"¹⁸ the Court stated that a "context-specific inquiry" would typically entail looking "to the nature of the alleged injury, the racketeering activity that directly caused it, and the injurious aims and effects of that activity."¹⁹

Applying these principles to the allegations here, the Court ruled that "[m]uch of the alleged racketeering activity that caused the injury occurred in the United States," and those "components of the scheme [that] occurred abroad . . . 'were devised, initiated, and carried out through acts and communications initiated in and directed towards Los Angeles County.'"²⁰ The Court highlighted three examples of racketeering activity that Yegiazaryan allegedly undertook, including his creation of "U.S. shell companies to hide his U.S. assets, submitting a forged doctor's note to a California District Court, and intimidating a U.S.-based

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witness.” Because “[t]he rights that the California judgment provides to Smagin exist only in California,” and the “alleged RICO scheme thwarted those rights,” “Smagin’s 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 that judgment in California.”²¹ Thus, instead of focusing on the award creditor’s non-U.S. residency, the Court was focused on the *situs* of (i) where the rights of the U.S. judgment had crystallized and (ii) where the alleged racketeering activity affecting such rights were taken in or directed from.

IMPLICATIONS

At first glance, the Supreme Court’s ruling on this case appears to lay the path for a foreign award creditor to bring a RICO claim against an award debtor if that debtor has engaged in certain racketeering activities in the U.S. that impairs or frustrates the foreign award creditor’s ability to enforce a U.S. judgment confirming the award. However, establishing a RICO claim on the merits is not a walk in the park; a mere failure to pay up on an arbitral award debt is not likely to be sufficient unless it is accompanied by other acts (as was the case here) that would constitute “predicate” criminal acts under the RICO Act.

Moreover, the Supreme Court in this instance merely considered whether one element of a RICO claim—a “domestic injury”—had been adequately pled; it did not address whether the other RICO elements had been met, nor did it actually award treble damages to the foreign award creditor. With respect to the “domestic injury” element itself, it is unclear how often a foreign award creditor would be able to plausibly allege racketeering activity with the requisite degree of nexus to the U.S., as existed here, in order to establish its standing to assert a RICO claim. In particular, although the Court rejected the award creditor’s residence as determinative, it remains to be seen whether courts will find the relevant U.S. nexus if *both* the award creditor and debtor are non-U.S. nationals residing *outside* the U.S. and the sole or primary U.S. nexus is the existence of a U.S. judgment on an arbitral award.

Overall, the Supreme Court’s ruling in this case adds a potential tool to an arbitration practitioner’s enforcement strategy, but it is not a particularly straightforward tool to deploy.

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ENDNOTES

- 1 18 U.S.C. § 1964(c).
- 2 *Grimmett v. Brown*, 75 F.3d 506, 510 (9th Cir. 1996).
- 3 18 U.S.C. § 1961.
- 4 *RJR Nabisco v. Eur. Cmty.*, 579 U.S. 325, 346 (2016).
- 5 18 U.S.C. § 1964(c).
- 6 *Smagin v. Yegiazaryan*, 2:14-cv-09764-R-PLA, ECF No. 1-3, Ex. 1 (C.D. Cal. Dec. 22, 2014).
- 7 *Yegiazaryan v. Smagin*, 599 U.S. at ____, slip op. at 2 (2023).
- 8 *Id.*
- 9 *Id.* at 3.
- 10 *Id.* at 2-3.
- 11 *Id.* at 3.
- 12 *Id.* (quoting App. 56a).
- 13 *Id.* at 3.
- 14 *Id.* at 4.
- 15 *Id.* (quoting App. 100a).
- 16 *Id.* at 4.
- 17 *Smagin v. Yegiazaryan*, 37 F.4th 562, 568, 570 (9th Cir. 2022).
- 18 *Yegiazaryan*, slip op. at 10.
- 19 *Id.* at 8-9.
- 20 *Id.*
- 21 *Id.* at 10-11.

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