533 F.3d 681, RICO Bus.Disp.Guide 11,532
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United States Court of Appeals,
Eighth Circuit.
Dave DAHLGREN, et al., Plaintiffs-Appellees,
v.
FIRST NATIONAL BANK OF HOLDREGE, Defendant-Appellant.

No. 07-1951.
Submitted: Dec. 12, 2007.
Filed: July 11, 2008.
Rehearing and Rehearing En Banc Denied Aug. 22, 2008.

LOKEN, Chief Judge.

When Damrow Cattle Company ("DCC") was placed in involuntary receivership and a Chapter 7 bankruptcy proceeding, fourteen cattle investors and corn producers [FN1] who were fattening cattle and storing grain at the DCC feedlot lost over $1.7 million plus nearly $200,000 in bankruptcy litigation expenses. They sued the First National Bank of Holdrege ("the Bank"), DCC's primary lender from 1983 until 2000, for treble damages and attorneys' fees under the Racketeering Influenced and Corrupt Organizations Act ("RICO") and for fraud and negligent misrepresentation under state law, claiming that the Bank misled them into continuing to do business with DCC by concealing its increasing financial weakness to protect the Bank's substantial interest as DCC's creditor. A jury found the Bank liable on all claims, and the district court denied without opinion the Bank's post-verdict motion for judgment as a matter of law. The Bank appeals. We reverse the denial of judgment as a matter of law on the RICO claims. Reviewing the facts in the light most favorable to the jury's verdict, we affirm in part and reverse in part the jury verdict on the various fraud claims. ***687** *See Fowler v. Smith-Kline Beecham Clinical Labs., Inc.*, 225 F.3d 1013, 1014 (8th Cir.2000) (standard of review).

FN1. Dave Dahlgren, Dahlgren's Inc., Theodore Collin, Lloyd Erickson, Erickson Land and Cattle, Dixon Granstra d/b/a Granstra Cattle, DG Farms, Inc., Skane, Inc., Clark Nelson, Wells AG Enterprises, Inc., Don Sjogren, BJW Farms, Inc., EWW Farms, Inc., and Dwayne Kudlacek.

I. Factual Background

Dennis Damrow ("Damrow") and his brother and father began operating DCC as a commercial feedlot near Holdrege, Nebraska, in 1983. The Damrows formed a financing company, DFF, Inc., that offered investors the option of borrowing the cost of purchasing and feeding cattle at DCC. Damrow was the general manager of DCC and managed the day-to-day operations of DFF. The Bank provided loans and banking services to both companies. In 1990, Damrow invested in and began managing a second feedlot, Carter Feeders, near Orleans, Nebraska. The Bank provided banking services for Carter Feeders and its financing entity, CFF, Inc.

Investors placed feeder cattle at the feedlot, where DCC fattened the cattle before selling them to meat packers. DCC billed investors monthly for feed and other costs. Investors who farmed in the area also stored grain at the feedlot, either to feed their own cattle or to sell to DCC. An investor financing the purchase and fattening of cattle through DFF signed a promissory note to DFF. DFF signed a promissory note and assigned the investor's note to the Bank in exchange for a loan to purchase the cattle. When DCC sold cattle to a meat packer, the packer sent the purchase price to the Bank, which deposited the funds into DCC's account. DCC recovered its feedlot expenses, reimbursed DFF for its advances, and paid the investor his down-payment and any profit from the sale. DFF repaid the Bank's loan. Investors commonly used their share of the sale proceeds to finance a new lot of cattle at DCC.

DCC experienced steady growth, expanding its operating capacity from 1,200 cattle in 1983 to 17,500 cattle when it was placed in receivership in 2001. Damrow testified that after 1996, DCC owned thirty to fifty percent of the cattle being fed at any given time. Dr. Rodney Jones, an agricultural economics professor, testified as plaintiffs' expert that the owner of cattle incurs greater risk in cattle feeding than the feedlot operator, so the percentage of cattle owned by the feedlot significantly affects its risk of loss.

From 1994 through 1998, Dr. Jones and others testified that the Bank repeatedly honored checks

when the DCC and DFF accounts were substantially overdrawn, sometimes in excess of $1 million, and DCC had no unborrowed amount on its working capital line of credit. DCC often waited months after selling a lot of cattle before using the proceeds to pay the corresponding DFF note, thereby using money borrowed by DFF to effectively increase DCC's borrowings. The Bank contributed to this credit-shifting process by refusing on multiple occasions to process DCC checks to pay off DFF notes when DCC's account was overdrawn. Dr. Jones testified that these large overdrafts suggested a borrower with cash flow problems that could lead to business failure. However, substantial overdrafts ceased after the DCC and DFF lines of credit were increased in mid-to-late 1997 when the Bank's correspondent regional bank, First National Bank of Omaha ("FNBO"), investigated Damrow and agreed to participate in these lines of credit. By May 1999, FNBO's participation in the DCC operating line of credit and the DFF investor line of credit had increased to a total of $7 million.

In 1996 and 1997, two junior officers at the Bank warned senior management of irregularities in the financing of DFF-large initial advances in round figures to purchase cattle and feed, some totaling ***688** more than the cattle would bring when sold; note maturities longer than the four-to-five months needed to fatten cattle; and DFF notes remaining unpaid for months after the cattle were sold. After receiving the second officer's critical memorandum, DCC loan officer Ron Sterr wrote a letter asking Damrow to address the problem of DFF overdrafts and overdue notes. However, Sterr and Bank president Kenneth Slominski excused the failure to pay DFF notes when cattle were sold by suggesting that Damrow was just replacing the sold cattle with new feeder cattle for the same investors.[FN2]

> FN2. Even if accurate, this rationale did not excuse the failure to use sale proceeds to pay off the *investors'* notes to DFF for the initial purchase of the sold cattle, notes held by the Bank as DFF's assignee. However, this lawsuit is not about that risk to the plaintiff investors, as all DFF notes were eventually paid.

In September 1997, the Bank entered into an agreement with the Office of the Comptroller of the Currency to address the Bank's deteriorating condition. The agreement required the Bank to make management changes, appoint an oversight committee, abide by new lending limits and procedures, and reduce classified and non-performing assets. A new president was hired in late 1998, charged with the task of eliminating classified and non-performing assets so that the Bank could achieve compliance with the regulatory agreement. Cattle losses in 1997 and 1998 caused DCC's loan rating at the Bank to decline from a "1" in 1997, to a "4" in mid-1999, which placed its line-of-credit loan on the Bank's "watch" list.

In September 1999, after years of losses and increasing liabilities, the nonDamrow shareholders at Carter Feeders told the Bank they suspected Damrow of falsifying financial statements by overstating the cattle owned by Carter Feeders by over $1 million. Damrow ceased managing Carter Feeders in November 12, and Carter Feeders declared bankruptcy in December 1999. Upset with the Bank's handling of the Carter Feeders problem, Damrow asked FNBO if it would take over all of the various Damrow credits in December 1999.

In January 2000, Damrow admitted to the Bank that he had filed false financial statements for Carter Feeders, blaming the other Carter Feeders shareholders. The Bank's board of directors decided to end its banking relationship with Damrow on January 9, 2000. After persuading Damrow to sign a new deed of trust on the DCC feedlot, which was owned by Damrow or his personal farming entity, the Bank told Damrow to find a new lender. Damrow continued discussions with FNBO, which took over the DCC and DFF credits on April 14 after conducting its own due diligence investigation. Participating with FNBO was Adams Bank & Trust, where loan officer Sterr began working after leaving the Bank in late 1999. The Bank severed its last tie with the Damrow credits on July 18, 2000, when a final term note was paid from proceeds of Damrow's sale of the feedlot property, consistent with his refinancing agreement with FNBO.

In January 2001, FNBO heard that double counting of cattle was occurring at the DCC feedlot. FNBO investigated and quickly placed DCC into receivership, liquidating its cattle inventory. An involuntary Chapter 7 bankruptcy followed. FNBO and Adams Bank & Trust sued the Bank for failing to disclose financial information about the Damrow operations; both cases settled. After litigating with

FNBO and the DCC trustee over ownership of corn and cattle at the feedlot when the receivership began, plaintiffs commenced***689** this action to recover from the Bank their losses and litigation expenses in the DCC bankruptcy. Damrow pleaded guilty to felony charges that, between December 1993 and January 2001, he schemed to defraud the Bank, FNBO, and Adams Bank & Trust by materially misrepresenting the ownership of cattle on borrowing reports to the banks, by falsifying documents to deceive inspectors and bank representatives regarding the ownership of cattle at the DCC and Carter Feeders feedlots, and by pledging to the banks cattle that were owned by others. Sentenced to forty months in prison, Damrow was incarcerated at the time of trial and testified for the plaintiffs by deposition.

II. The RICO Claims

Enacted to strengthen criminal and civil remedies against organized crime, RICO provides a private right of action for any person "injured in his business or property by reason of a violation of" its substantive prohibitions. 18 U.S.C. § 1964(c). The prohibition at issue here is 18 U.S.C. § 1962(c), which provides:

> It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

To prevail on their RICO claims, plaintiffs must prove that the Bank engaged in the conduct of an enterprise through a pattern of racketeering activity. The enterprise in question was DCC. The Bank's alleged predicate acts of racketeering were multiple instances of mail fraud and wire fraud as defined in 18 U.S.C. §§ 1341 and 1343, offenses that are included in the definition of "racketeering activity" in 18 U.S.C. § 1961(1)(B). To constitute racketeering activity under RICO, the predicate acts must be related and must "amount to or pose a threat of continued criminal activity." *H.J. Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 239, 109 S.Ct. 2893, 106 L.Ed.2d 195 (1989). "Any recoverable damages occurring by reason of a violation of § 1962(c) will flow from the commission of the predicate acts." *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 496, 105 S.Ct. 3275, 87 L.Ed.2d 346 (1985). "Though mail fraud can be a predicate act, mailings are insufficient to establish the continuity factor unless they contain misrepresentations themselves." *Wisdom v. First Midwest Bank of Poplar Bluff*, 167 F.3d 402, 407 (8th Cir.1999).

The Bank argues that plaintiffs introduced insufficient evidence that the Bank "conduct[ed] or participate[d], directly or indirectly, in the conduct of [DCC's] affairs through a pattern of racketeering activity" within the meaning of § 1962(c). We agree. "In order to participate, directly or indirectly, in the conduct of [an] enterprise's affairs, one must have some part in directing those affairs." *Reves v. Ernst & Young*, 507 U.S. 170, 179, 113 S.Ct. 1163, 122 L.Ed.2d 525 (1993) (quotations omitted). Although § 1962(c) liability is not limited to those with a formal position within the enterprise:

> § 1962(c) cannot be interpreted to reach complete "outsiders" because liability depends on showing that the defendants conducted or participated in the conduct of the "*enterprise's* affairs," not just their *own* affairs. Of course, "outsiders" may be liable under § 1962(c) if they are "associated with" an enterprise and participate in the conduct of *its* affairs-that is, participate in the operation or management of the enterprise itself....

Id. at 185, 113 S.Ct. 1163 (emphasis in original). Thus, the word "conduct" means ***690** the Bank exercised some degree of control over the operation or management of DCC's affairs.

When the RICO defendant was the alleged enterprise's principal lender, a court considering a motion for summary judgment or for judgment as a matter of law must carefully distinguish between the bank conducting its own affairs as creditor, and the bank taking additional steps as an outsider to direct the operation or management of its customer, the RICO enterprise. As the Third Circuit stated in a similar case, "While it is certainly true that a major creditor of a corporation can have substantial persuasive power and some legal authority over [a borrowing customer's] management, alone, such power is not equivalent to having the power to conduct or participate directly or indirectly in the conduct in the affairs of those corporations." *Dongelewicz v. PNC Bank Nat'l Ass'n*, 104 Fed.Appx. 811, 817-18 (3d Cir.2004) (unpublished) (quotations omitted), *cert. denied*, 543 U.S. 1096, 125 S.Ct. 965, 160 L.Ed.2d 910 (2005). A

bank's financial assistance and professional services may assist a customer engaging in racketeering activities, but that alone does not satisfy the stringent "operation and management" test of *Reves*. *See* *Schmidt v. Fleet Bank*, 16 F.Supp.2d 340, 346-48 (S.D.N.Y.1998), and cases cited.[FN3] In *Schmidt*, allegations that the bank approved overdrafts on 500 occasions, misrepresented the status of accounts to investors, and helped its customer conceal his fraudulent scheme were held to be insufficient to satisfy this test. Plaintiffs have not cited and we have not found any post- *Reves* case in which a bank or financial services company was held to have conducted the affairs of a RICO enterprise that was an unrelated customer of the bank.[FN4]

FN3. Abrogated on other grounds by *Pavlov v. Bank of New York Co.*, 25 Fed.Appx. 70 (2d Cir.2002) (unpublished).

FN4. In *Brown v. LaSalle Northwest Nat'l Bank*, 820 F.Supp. 1078, 1082 (N.D.Ill.1993), affiliates of the bank were the RICO enterprise.

With one possible exception, all of the Bank's actions that plaintiffs cite as evidence of the Bank's control of DCC fall into the category of a creditor conducting its own affairs. The Bank allowed the commingling of Damrow entity funds, honored substantial overdrafts (in effect, informally increasing the borrower's line of credit, for a one-time fee), allowed DFF notes to the Bank to remain past due (again, thereby increasing DCC's line of credit), honored DCC n.s.f. checks to investors, recommended its customer DCC to other Bank customers, encouraged its correspondent regional bank to participate in the lines of credit, told Damrow he must increase equity investment and eliminate intra-enterprise liabilities on DCC's financial statement to get a loan approved, transferred funds between Damrow entity accounts pursuant to loan agreement cross-guarantees without Damrow's permission, and required Damrow to sign a new deed of trust on the feedlot. As the court held in *Schmidt*, simply because a bank *allows* a heavily indebted customer to take actions such as overdrafts and late note payments that the bank might prevent by exercising its formidable rights as creditor is not evidence that the bank controlled the customer's operations and management. 16 F.Supp.2d at 346-48. "Bankers do not become racketeers by acting like bankers." *Terry A. Lambert Plumbing, Inc. v. Western Sec. Bank*, 934 F.2d 976, 981 (8th Cir.1991).

The possible exception, which plaintiffs greatly emphasized at trial and on appeal, involved the Bank's actions when a substantial Damrow customer, John Morken, ***691** became insolvent in 1994. In June 1994, Damrow learned that Morken was facing bankruptcy. The Bank had advanced some $5 million on DFF and CFF notes secured by cattle that Morken was then feeding at the DCC and Carter Feeders feedlots. DCC was also an unsecured creditor for grain fed to those cattle, and Damrow testified he had received payments from Morken that might be voidable preferences in a Morken bankruptcy. Damrow immediately contacted Slominski at the Bank. Slominski and the Bank's attorney decided that the Bank would foreclose on the cattle and that DCC and Carter Feeders would buy the foreclosed cattle for the amount of the DFF and CFF notes, using funds borrowed from the Bank. Damrow testified that he was hesitant to purchase the Morken cattle but did so because of his twenty-year relationship with the Bank, because Slominski promised him that DCC would not suffer financially, and because it was the only way he could recover DCC's substantial claim for feed "owed off the John Morken cattle."

Following the foreclosures, the Bank discovered that some of the foreclosed notes were signed by Morken personally, rather than as an officer of his company, Spring Grove Livestock. The Bank did not have perfected security interests in cattle owned by Morken personally. Damrow testified that Slominski and the Bank's attorney drove to the DCC feedlot and had the Morken notes altered, using the typewriter Damrow used to create the notes to add "Spring Grove Livestock" on the top of each note and "authorized agent" above Morken's signature. The Morken and Spring Grove bankruptcy trustees discovered the alterations and sued the Bank, DCC, Carter Feeders, DFF and CFF to set aside the foreclosures and to recover the entire value of the DFF and CFF notes. The parties negotiated, and Slominski told Damrow the Bank wanted to settle the dispute with the trustees for $2.6 million, with the Bank paying half and DCC and Carter Feeders paying the other half, using funds borrowed from the Bank. Damrow testified that, after Slominski threatened not to renew the DCC and Carter Feeders lines of credit, Damrow met with their other shareholders, who unanimously agreed to settle.

Plaintiffs argue that the Bank controlled DCC's actions in purchasing the Morken cattle at an inflated foreclosure price, illegally altering the Morken notes, and agreeing to a costly settlement with the trustees, leaving DCC with a debt burden that ultimately led to its receivership some six years later. Plaintiffs note that DCC had only a small stake in the Morken bankruptcy-its unpaid feed-because DCC had not guaranteed the DFF and CFF notes to the Bank. Therefore, the Bank, not Damrow, must have controlled DCC's irrational decision to help fund the settlement. We certainly agree that the Bank's action in altering the Morken notes was shameful. But it was Damrow who made the decisions that DCC would help purchase the cattle in foreclosure and contribute to the settlement of claims by the Morken and Spring Grove trustees. Urging Damrow to take those actions was consistent with the Bank's control of its own affairs as creditor. And those decisions were not so irrational, from Damrow's and DCC's perspective, as to demonstrate that the Bank was controlling DCC. [FN5] More importantly, this was an isolated incident***692** that occurred long before the Bank's alleged predicate acts with the plaintiffs. Therefore, even assuming that a rational jury could believe the testimony of Damrow-who was convicted of defrauding the Bank and other DCC lenders-that the Bank controlled DCC's actions in these unfortunate transactions, that is not sufficient evidence that the Bank "engaged ... in the conduct of [DCC's] affairs through a pattern of racketeering activity" that injured the plaintiffs years later.[FN6]

> FN5. Damrow testified that the settlement permitted the Damrow and Carter Feeders entities to avoid possible preference claims relating to the $8-9 million of feedlot business in the 90 days before the Morken and Spring Grove bankruptcies. More significantly, every DCC and Carter Feeders shareholder met personally with the Bank and agreed to those companies participating in the settlement.

> FN6. Our decision in *Handeen v. Lemaire*, 112 F.3d 1339 (8th Cir.1997), on which plaintiffs heavily rely, is clearly distinguishable for this reason, and others.

Because plaintiffs failed to establish that the Bank directed the operations or management of DCC during the time they were allegedly injured by the Bank's pattern of racketeering activity, the district court erred in denying the Bank's motion for judgment as a matter of law dismissing their RICO claims. Therefore, we need not consider the Bank's arguments that plaintiffs failed to prove other elements of these claims.

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C.A.8 (Neb.),2008.
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