

**IN THE UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

<b>FL RECEIVABLES TRUST 2002-A</b>	:	<b>CIVIL ACTION</b>
	:	
<b>v.</b>	:	<b>NO. 03-CV-5108</b>
	:	
<b>PAUL BAGGA, <u>et al.</u></b>	:	

**MEMORANDUM AND ORDER**

**Kauffman, J.**

**March 8, 2005**

Plaintiff FL Receivables Trust 2002-A (“Plaintiff”) brings this action for violations of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961, et seq. (“RICO”) (Count One), conspiracy to violate RICO (Count Two), a declaration that the corporate forms of Defendants Bagga Enterprises, Inc. (“Bagga Enterprises”), Jamuna Real Estate, LLC (“Jamuna”) and United Management Services LLC (“United Management”) are a nullity (Count Three), fraudulent transfer (Count Four) and conversion (Count Five). Defendants Paul Bagga, Khushvinder Bagga, Bagga Enterprises, Jamuna, United Management, K & P Real Estate LLC (“K&P”), American Merchandise Company, Inc. (“American Merchandise”), and 21st Century Restaurant Solutions, Inc. (“21st Century”) (collectively the “Bagga Defendants”) have filed a Motion to Dismiss the Amended Complaint pursuant to Fed. R. Civ. P. 12(b)(6). Defendants Ravinder Chawla and World Apparel Products, Inc. (“World Apparel”) have filed a similar motion, as has Defendant Sant Properties, Inc. (“Sant”). For the reasons that follow, the motions as to Counts One and Two will be granted; as to the remaining Counts, the motions will be denied.

**I. BACKGROUND**

Plaintiff alleges that Defendants have formed an enterprise which is run by Defendants Praptal Bagga, Khushvinder Bagga, Ravinder Chawla, and Hardeep

Chawla. Defendants Praptal Bagga and Khushvinder Bagga (“the Baggas”) are husband and wife, while Defendants Ravinder Chawla and Hardeep Chawla (“the Chawlas”) are brothers. The Chawlas and Baggas are cousins. *Id.* at ¶¶ 8 - 9. The Baggas and the Chawlas run a number of businesses, all of which are defendants in this case.

*A. The Captec Loans*

The dispute between the parties stems from a number of loans Plaintiff’s predecessor in interest, Captec Financial Group, Inc. (“Captec”), made to Bagga Enterprises and Jamuna (collectively, “the borrowers”). The borrowers are both Bagga-owned entities. Amended Complaint at ¶ 24. Between September 2000 and January 2001, Captec made seven loans to the borrowers which totaled nearly \$4 million. Welcome Group, Inc. (“Welcome”) and Defendant United Management (collectively “the guarantors”) served as guarantors on the loans. *Id.* at ¶¶ 24 - 25.

In May 2001, the borrowers stopped making payments on their respective loans. Soon thereafter, the guarantors defaulted on their guarantees. *Id.* On or about December 20, 2002, Captec obtained default judgments against the borrowers and the guarantors. Several months later, Captec transferred those judgments to Plaintiff. *Id.* at ¶ 26. Plaintiff is now attempting to execute on the judgments and has conducted extensive discovery. See FL Receivables Trust 2002-A v. Bagga Enterprises, Inc., et al., No. 02-2080 (E.D. Pa. filed Apr. 12, 2002) (the “collection action”).

The collection action addresses the injury Captec suffered when the borrowers failed to satisfy their loan obligations. The present action, in contrast, is based on Defendants’ alleged fraud. The basic theory is that Defendants, through their enterprise, (1) fraudulently induced Captec to agree to the loans; (2) contrived to insulate themselves from any judgment Captec or its successors in interest might obtain; and (3) used the proceeds of the Captec loans and others to enrich themselves.

### *B. Alleged Fraudulent Inducement of the Captec Loans*

According to the Amended Complaint, Bagga Enterprises represented to Captec that four of the seven Captec loans would be used to purchase restaurant equipment, which would then serve as security for the loans. *Id.* at ¶¶ 27 - 29. To establish the value of the equipment, Bagga Enterprises submitted a number of price-lists to Captec. *Id.* at ¶ 31. Unknown to Captec, the price-lists had been prepared by World Apparel, one of the companies owned by the Chawlas. The Amended Complaint alleges that World Apparel, acting in furtherance of the enterprise, dramatically overstated the value of the restaurant equipment. *Id.* at ¶¶ 32 - 34. As a result of this deception, Captec loaned Bagga Enterprises significantly more money than the company needed to purchase the equipment, and received less security on the loans than it had bargained for. Plaintiff also alleges that the borrowers and guarantors intentionally concealed a number of outstanding loans and other liabilities from Captec, causing a false impression as to the risk Captec was undertaking in making the loans.

In sum, Plaintiff alleges that the borrowers used deception and misrepresentation to induce Captec to make the loans and that they took Captec's money and executed the promissory notes without ever intending to repay. *Id.* at ¶ 39.

### *C. Defendants' Alleged Scheme to Insulate the Borrowers and Guarantors from Judgment*

Plaintiff alleges that Defendants, through their enterprise, employed a number of tactics to prevent Captec and Plaintiff from recovering on the default judgment. For example, they commingled funds from the various Bagga and Chawla entities. *Id.* at ¶¶ 41 - 44. This was accomplished by having receipts from the Baggas' Arby's restaurant franchise and revenues from the Baggas' clothing business "swept" into a single account, owned by United Management. *Id.* at ¶ 43. This commingling of funds has made it impossible to tell which assets belong to the borrowers (and are therefore

within reach of Plaintiff's default judgment) and which belong to other Bagga-Chawla entities.

Defendants also hid the borrowers' assets through multiple disbursements to various other Bagga-Chawla entities. Essentially, the enterprise directed United Management to use the funds from the Captec loans (which were already commingled with money from American Merchandise) to give distributions to "third parties, including a payroll company owned by the Baggas, restaurant suppliers, insiders, corporate affiliates and others." *Id.* at ¶ 87. Khushvinder Bagga was able to further deplete the United Management fund by making personal withdrawals in 2002 – withdrawals that were not subject to corporate controls. *Id.* at ¶¶ 90 - 91. All of this, Plaintiff contends, had the effect of putting the borrowers' assets beyond Plaintiff's reach.

The Amended Complaint alleges that Defendants engaged in a number of other tactics to insulate their assets from creditors. Those include deception,<sup>1</sup> fraudulent Chapter 11 filings,<sup>2</sup> destruction of financial and other records,<sup>3</sup> and movement of funds abroad.<sup>4</sup>

#### *D. The Baggas' Alleged Self-Enrichment Scheme*

According to the Amended Complaint, the Baggas achieved a significant personal profit from the fraudulently induced loans. They received nearly \$2 million in payments from their companies – payments that were made at the same time the Baggas were telling the companies' creditors that they were not able to meet their debt

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<sup>1</sup> See Complaint at ¶¶ 57 - 68.

<sup>2</sup> See Complaint at ¶¶ 123 - 133.

<sup>3</sup> See Complaint at ¶¶ 140 - 148.

<sup>4</sup> See Complaint at ¶¶ 134 - 139.

obligations. Id. at ¶¶ 77 - 83. Some of the payments took the form of distributions, while others were labeled management fees. Id. at ¶ 78.

## II. LEGAL STANDARD

When deciding a motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6), the Court may look only to the facts alleged in the complaint and its attachments. Jordan v. Fox, Rothschild, O'Brien & Frankel, 20 F.3d 1250, 1261 (3d Cir. 1994). The Court must accept as true all well-pleaded allegations in the complaint and view them in the light most favorable to the plaintiff. Angelastro v. Prudential-Bache Sec., Inc., 764 F.2d 939, 944 (3d Cir. 1985). A Rule 12(b)(6) motion will be granted only when it is certain that no relief could be granted under any set of facts that could be proved by the plaintiff. Ransom v. Marrazzo, 848 F.2d 398, 401 (3d Cir. 1988).

## III. ANALYSIS

### *A. Plaintiff's Standing to Bring a RICO Claim*

The Motions to Dismiss argue that Plaintiff lacks standing to assert a RICO claim until its collection action against the borrowers and guarantors has concluded and its loss as a result of Defendants' allegedly fraudulent conduct has been established. See Bagga Motion at 38; Sant Motion at 19.<sup>5</sup>

Standing to bring a RICO claim "is conferred upon 'any person injured in his business or property by reason of a violation of section 1962[.]'" Maio v. Aetna, Inc., 221 F.3d 472, 482-83 (3d Cir. 2000) (citing 18 U.S.C. § 1964(c)). "A showing of injury requires proof of a *concrete financial loss* and not mere injury to a valuable intangible property interest." Id. at 483 (citing Steele v. Hosp. Corp. of Am., 36 F.3d 69, 70 (9th Cir. 1994) (emphasis added) (internal quotation marks omitted)). To qualify as a "concrete

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<sup>5</sup> The Chawla Motion explicitly adopts the argument contained in the Sant's Motion to Dismiss.

financial loss,” a plaintiff’s injury cannot be speculative or contingent on future events. Id. at 495; see also Johnson v. Heimbach, 2003 WL 22838476 at \*4 (E.D. Pa. Nov. 25, 2003). Rather, it must be an ascertainable out-of-pocket loss. Maio, 221 F.3d at 483-84 (collecting cases).

Defendants argue that the injuries alleged by Plaintiff cannot be determined without speculating on future events. In a case like this, Defendants argue, where Plaintiff has alleged the fraudulent inducement of a loan and efforts to preclude collection by concealing assets, the “out-of-pocket” damages would be measured by the amount of money Plaintiff would have received had Defendants honored their obligation minus what Plaintiff actually received. That would constitute the sum of financial loss caused by the fraud. See Sedima, S.P.R.L v. Imrex Co., Inc., 473 U.S. 479, 497 (1985) (“[T]he compensable injury [on a RICO claim] necessarily is the harm caused...”); First Nationwide Bank v. Gelt Funding Corp., 27 F.3d 763, 768 (2d Cir. 1994)(“In determining fraud damages, any amount recovered by the fraudulently induced lender necessarily reduces the damages that can be claimed as a result of the fraud.”) In this case, Defendants argue, the amount Plaintiff will recover on the contract depends on the outcome of its pending collection action against the borrowers and guarantors. Thus, Plaintiff’s injury is still speculative and contingent on future events. Accordingly, Defendants argue, Plaintiff has not alleged a “concrete financial loss,” and lacks standing to bring a RICO claim.

Neither the Third Circuit nor the Supreme Court has as yet considered Defendants’ theory that a creditor’s RICO claim is not ripe until he concludes his contract-based collection action. Other circuits, however, have found the theory persuasive and have adopted it. See Lincoln House, Inc. v. Dupre, 903 F.2d 845 (1st Cir. 1990) (holding that plaintiff lacked standing to bring a RICO claim based on defendants’ attempts to conceal their assets because underlying breach of contract claim was

unresolved); First Nationwide Bank v. Gelt Funding Corp., 27 F.3d 763 (2d Cir. 1994) (Lender lacks standing under RICO until it has foreclosed on all of its loans); Bankers Trust Co. v. Rhoades, 859 F.2d 1096, 1106 (2d Cir. 1988) (holding that a RICO injury does not occur until it becomes clear that a loan will not be repaid); Barnett v. Stern, 909 F.2d 973, 977 n.4 (7th Cir. 1990) (stating that creditors could not proceed with their RICO claim until their recovery from the defendant's bankruptcy became clear).

Plaintiff makes no effort to distinguish these cases or to argue that they are inapplicable; instead, Plaintiff asserts that the cases were wrongly decided. See Plaintiff's Opposition Memo at 53 - 59. The Court disagrees. First, while it is true that the Third Circuit has not directly ruled on this question, it has favorably cited a number of cases that agree with Defendants' reading of the RICO standing requirements. See Maio, 221 F.3d at 495; Matthews v. Kidder, Peabody, & Co., Inc., 260 F.3d 239 (3d Cir. 2001) (holding that a creditor's RICO injury does not become concrete enough for the statute of limitations to accrue until he exhausts his contractual remedies).<sup>6</sup>

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<sup>6</sup> In Maio, for example, the court cited First Nationwide Bank, 27 F.3d 763 (2d Cir. 1994), for the proposition that a RICO injury cannot be speculative or contingent on future events, and specifically noted that First Nationwide Bank involved a creditor's injury from a fraudulently induced loan. See Maio, 221 F.3d at 495. Matthews is an even more compelling example. The plaintiffs in that case were a number of first-time investors who had brought RICO claims based on the defendants' misrepresentations as to the risk involved in the investments they were promoting. The district court had granted the defendants' motion for summary judgment on the grounds that the statute of limitations on the RICO claim had expired. In the course of reviewing that decision, the Third Circuit examined when the plaintiff's RICO injury took place. The court found that the injury was sufficiently concrete at the time the investment was fraudulently induced to trigger the statute of limitations. Id. at 248-49. However, the court was careful to point out that its conclusion was not inconsistent with the line of Second Circuit cases holding that a defrauded creditor's injuries are not sufficiently concrete to confer standing until he has exhausted his contractual remedies. Id. at 248 (citing First Nationwide Bank, 27 F.3d at 767-78). The plaintiffs in Matthews, the court explained, had been fraudulently persuaded to purchase *equities*, and so lacked a "contractual remedy for the losses incurred." Id. at 249. But in a debt situation, where such remedies do exist (as they do in this case), the injury is not concrete enough until the note holder exhausts his contractual remedies. Id. at 248, n.11.

Moreover, the Maio Court left no doubt that an injury that is speculative or contingent on future events does not confer RICO standing. Maio, 221 F.3d at 495. That principle has a clear application to these facts, as the scope of Plaintiff's injury in this case – the money it has lost due to the borrowers' failure to honor the loan agreements – depends directly on the results of Plaintiff's currently pending collection action. To that extent, Plaintiff's injury does not confer standing to bring a RICO claim. Accordingly, the Motions to Dismiss will be granted as to Counts One and Two.

*B. Plaintiff's Common Law Fraud Count*

The Bagga Defendants argue that Count IV of the Complaint, which alleges that Praptal and Khushvinder Bagga engaged in a fraudulent transfer, should also be dismissed. First, they argue that this fraud claim fails to meet the heightened pleading standards required by Fed. R. Civ. P. 9(b), because Plaintiff has failed adequately to allege that the transfers were fraudulent, that they were made with fraudulent intent or that Defendants benefitted from the transfers. See Bagga Defendants' Memorandum at 35.

Rule 9(b) requires that "in all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally." Fed. R. Civ. P. 9(b). In this Circuit, a plaintiff's complaint must set out the circumstances of the fraud with enough particularity to "place the defendants on notice of the precise misconduct with which they are charged, and to safeguard defendants against spurious charges of immoral behavior." Seville Indus. Mach. Corp. v. Southmost Mach. Corp., 742 F.2d 786, 791 (3d Cir. 1984); In re: Rockefeller Ctr. Prop., Inc. Sec. Litig., 311 F.3d 198, 216 (3d Cir. 2002). While providing allegations of "date, place or time" is one means of giving the defendant adequate notice, it is not exclusive: "Plaintiffs are free to use alternative means of injecting precision and some measure of substantiation into their

allegations of fraud.” Id.

The type of fraud Plaintiff has alleged is governed by Pennsylvania’s Fraudulent Transfers Act, under which a plaintiff creditor states a claim against a debtor by showing that the creditor made a transfer or incurred an obligation either (1) with actual intent to hinder, delay or defraud any creditor of the debtor; or (2) “without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.” See 12 Pa. C.S.A. §§ 5104, 5105.

The question before the Court, therefore, is whether Plaintiff has alleged a fraudulent transfer, as defined by the statute, with sufficient precision to provide Defendants with notice. Plaintiff specifically identifies three distinct transactions with which the Baggas paid themselves nearly \$2 million, and alleges that these transactions took place at approximately the same time the companies from which the funds were withdrawn defaulted on their loans. Complaint at ¶¶ 78 - 79. Although the Complaint does not identify specific dates for the transactions, it does specify the exact amounts involved as well as the participants. Id. Such allegations are sufficiently precise to put Defendants on notice of the transactions that form the basis of Plaintiff’s claim. Moreover, since Rule 9 requires only general averments as to state of mind, Plaintiff’s allegation that the funds were transferred to the Baggas “with the intention to hinder, delay or defraud the creditors of Bagga Enterprises and Jamuna” is adequate. Id. at ¶ 196. Accordingly, the Court concludes that Plaintiff has met the requirements of Rule 9(b).

Defendants also argue that Plaintiff’s fraud claim should be dismissed based on the gist of the action doctrine, which is designed to preserve the conceptual distinction between tort and contract claims – a task it accomplishes by barring tort claims that are fundamentally contractual in nature. Pittsburgh Constr. Co. v. Griffith, 834 A.2d 572,

582-83 (Pa. Super. Ct. 2003). In determining on which side of the contract/tort divide a claim falls, courts consider the nature and basis of the obligation the defendant is alleged to have violated. Thus, “a claim should be limited to a contract claim when the ‘parties’ obligations are defined by the terms of the contracts, and not by the larger social policies embodied in the law of torts.” Bohler-Uddeholm America, Inc. v. Ellwood Group, Inc., 247 F.3d 79, 104 (3d Cir. 2001) (quoting Bash v. Bell Tel. Co., 601 A.2d 825, 830 (1992)). A tort claim may still lie against a defendant even though the conduct on which the tort is based falls within the scope of a contract. That a defendant’s conduct is governed by the contract, therefore, is not dispositive; rather, the essential question is whether the defendant’s conduct violates some additional duty that is distinct from the obligations the defendant accepted by entering into the contract. See Bohler-Uddeholm, 247 F.3d at 105 (“This duty imposed obligations on [the defendant] that went well beyond the particular obligations contained in the [a]greement itself”).

In this case, Plaintiff’s fraudulent transfer claim involves allegations that go beyond Defendants’ failure to honor their contractual obligations. Plaintiff has alleged that Defendants have attempted to conceal their assets in order to keep Plaintiff from exercising its legal rights. There is an important difference between the Baggas’ failure to pay Plaintiff, and their alleged attempts to prevent Plaintiff from collecting; the latter are intentionally designed to frustrate the operation of the law. To that extent, Plaintiff’s fraud claim is based on the Baggas’ violation of a duty grounded in larger social policies, rather than merely the terms of the parties’ agreement. Accordingly, the Court finds that Plaintiff’s fraud claim is not barred by the gist of the action doctrine.

#### **IV. CONCLUSION**

For the foregoing reasons, the Court will grant Defendants’ Motions to Dismiss as to Counts One and Two; as to the remaining Counts, the Motions will be denied. An appropriate Order follows.

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FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

<b>FL RECEIVABLES TRUST 2002-A</b>	:	<b>CIVIL ACTION</b>
	:	
<b>v.</b>	:	<b>NO. 03-CV-5108</b>
	:	
<b>PAUL BAGGA, <u>et al.</u></b>	:	

**ORDER**

**AND NOW**, this 8<sup>th</sup> day of March, 2005, upon consideration of Defendants' Motions to Dismiss the Amended Complaint (docket nos. 28, 29, and 30), and for the reasons stated in the accompanying Memorandum, it is **ORDERED** that the Motions are **GRANTED** as to Counts One and Two, and **DENIED** as to the remaining Counts.

**BY THE COURT:**

**S/Bruce W. Kauffman  
BRUCE W. KAUFFMAN, J.**