

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

UNITED STATES OF AMERICA, : CRIMINAL ACTION
: :
: : NO. 02-324-1
v. :
: :
JAMES C. FALLON, :
: :
Defendant. :

ORDER AND MEMORANDUM

AND NOW, this 3rd day of May, 2007, upon remand by the Court of Appeals for the Third Circuit for further proceedings on the issue of restitution consistent with its opinion in United States v. Fallon, 470 F.3d 542 (3d Cir. 2006), upon consideration of the Government’s Memorandum of Law for Restitution Re-Hearing and Defendant James C. Fallon’s Restitution Memorandum, and after a hearing on restitution on April 26, 2007, it is hereby ORDERED that Defendant shall make restitution in the amount of \$57,437.80, which is due immediately, at a rate of not less than \$500.00 per month, for the reasons that follow.¹

In Fallon, the Third Circuit reiterated that under the Mandatory Victims Restitution Act, 18 U.S.C. § 3663A, “restitution must be based upon losses directly resulting from the defendant’s criminal conduct.” Id. at 548 (quoting United States v. Quillen, 335 F.3d 219, 222 (3d Cir. 2003)) (internal quotation and alterations omitted). The Third Circuit stated that “where, as here, the government demonstrates that a business transaction was consummated due to fraud

¹ The amount of \$500.00 per month will be subject to review by a court upon report from the supervising Probation Department in six months to determine whether Defendant’s monthly restitution payment is a fair amount or should be increased. All other provisions of this court’s Judgment and Commitment Order dated October 14, 2003 remain in full effect.

by the defendant, a commonsense, but rebuttable inference arises that subsequent losses suffered by the victim of the fraud are sufficiently linked to the underlying fraud to support an award of restitution.” Id. at 549.

The Third Circuit concluded that Defendant had presented sufficient evidence to rebut portions of the restitution award as to lease payments missed by two doctors, one who was dead and the other who had filed for bankruptcy. Id. at 549-50. These leases, as well as certain others, are no longer at issue, having been conceded by the Government. The Third Circuit noted that although the enforceability of the outstanding lease contracts should be considered with respect to restitution, it was uncertain that the doctors would have colorable fraudulent inducement claims because “Derma Peel” was exempted from pre-clearance requirements prior to the start date of the leases.² Id. The appeals court vacated this court’s prior restitution order and remanded the matter for a new restitution hearing. Id. at 550.

ABL’s loss for restitution purposes is that which it could not collect due to Defendant’s fraudulent actions. ABL financed \$25,000 per lease agreement. Only lease agreements as to three entities are now at issue. First, as to the Dermatology Center, the unrebutted testimony is

² The consequences of Defendant’s fraudulent actions placed American Business Leasing (“ABL”) either in the position of not being able to enforce its financing agreements, or in a position such that it could not, in good conscience, attempt to enforce the financing agreements because any such attempt would likely be countered with the defense of fraud in the inducement. Defendant’s fraudulent conduct thus forced ABL into the position of making a business judgment that was premised upon the presumption that every financing agreement dishonored was due to misrepresentation of the Derma Peel device as having been approved by the Food and Drug Administration (“FDA”). This was a reasonable business decision. Principles of good faith and fair dealing were part and parcel of the agreements. Fraud is inconsistent with those principles. Whether ABL could have prevailed ultimately against a fraud in the inducement defense is not the measure of its direct loss. Rather, the measure of its direct loss is having been put in the position of having to make the business operations decision by reason of Defendant’s fraud.

that ABL did not collect \$24,743.64 when the Center dishonored the agreement. Second, as to Dr. Griffin, the loss for two leases was \$42,646.10. Third, as to the Plastic Surgery Center, the loss was \$48.06.

The presumption in each of these cases is that the devices were returned because of fraud by the Defendant and that the agreements were dishonored because of the Defendant's fraudulent actions. As to each of the four devices at issue, Defendant has presented no evidence or testimony from any of the contracting parties that the devices were returned for reasons other than the misrepresentation regarding FDA approval. As to Dr. Griffin, Marilyn Peterson, an investigator for the Federal Defender Association, testified that Dr. Griffin stated that the lease payments were too high. Peterson's testimony as to Dr. Griffin is hearsay and not competent rebuttal evidence. Dr. Griffin did not submit an affidavit and was not subjected to cross-examination. His statement to Peterson may have been shorthand for dissatisfaction with the misrepresentation that the devices had been FDA approved. Because Defendant has not rebutted the presumption that the devices were returned and the agreements dishonored because of Defendant's fraudulent actions, the court concludes that Defendant's conduct was the precipitating basis for termination of Dr. Griffin's leases, the Dermatology Center lease, and the Plastic Surgery Center lease. The total loss for these leases is \$67,437.80.

Defendant advances three main arguments. First, Defendant argues that the court should assume the devices were returned by each of the above three contracting parties to ABL. The court credits testimony that these four devices were not returned to ABL, which was a financing company and not a manufacturer or distributor. Defendant has not met his burden to establish that the devices were returned to the distributors and that the distributors thereafter caused the

financed value of the devices to be returned to ABL.

However, the court will credit \$10,000 to Defendant for the total residual value of the four devices. The lease agreements contained the provision that the residual value of the device at the end of the lease life was ten percent of the starting value of \$25,000, thus equaling \$2,500. Again, there is no evidence that the devices were returned to the distributors or that any devices returned were subject to an arrangement with ABL such that there was a subsequent financing agreement. The court concludes that the devices returned were not resold. There is no evidence of this. The court assumes that the financing company had a security interest in the physical devices, which presumably, if not sold, would be sitting on a shelf in the used equipment inventory. As such, the residual value of each device would be \$2,500. This amount also is consistent with testimony presented at the restitution hearing regarding the advertised resale amount for used and refurbished devices through the internet. The residual value of the four machines, totaling \$10,000, is what ABL could now theoretically obtain for the devices. Subtracting this credit from the loss amount above, the resulting loss is \$57,437.80.

Second, Defendant argues that if ABL wrote off its losses for tax purposes, no restitution is owing. Defendant has not met his burden to prove a write-off by ABL. Furthermore, as a matter of law, the loss is a loss, whether or not there was a write-off. Any restitution recovery would have to be reported as taxable income. Tax effects have nothing to do with the obligations of restitution.

Finally, the court rejects Defendant's argument that the court should look at all of ABL's leases and profits in determining ABL's losses. ABL is entitled to receive no more than its loss. Therefore, it is necessary to examine each financing agreement separately to determine loss and

resulting restitution. ABL lent \$25,000 per device and did not receive this amount in return for the four dishonored leases. The difference in what ABL lent and what it actually received is ABL's loss and Defendant's obligation to repay in full.

BY THE COURT:

S/ James T. Giles
J.