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The Counselor

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Fraudster and victim both fail to shift loss

BY STEPHEN M. PROCTOR

Anyone faced with a claim or a loss will look for someone else to pay the claim or bear the loss. In an interesting decision from the 7th Circuit Court of Appeals, Judge Easterbrook declined to do so in three cases. The losses were caused by fraud and, ironically, both the perpetrator of the fraud and the victim failed in their efforts to shift their loss. (*Daniel J. Ratajczak, Jr., et al., v. Beazley Solutions Limited and Land O'Lakes, Inc. and First Mercury Insurance Company, et. al. v. Daniel J. Ratajczak, Jr., et. al.*, 7th Circuit Court of Appeals, No. 16-3418, August 31, 2017).

Daniel J., Scott A., and Angela Ratajczak ("Ratajczaks") ran an apparently successful business called Packerland Whey Products, Inc. Packerland purportedly manufactured

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Every company needs an anti-harassment program

BY ALAN M. KAPLAN

The disgusting and disquieting disclosures of sexual harassment could cause all employers to audit, assess and avoid the legal and employee relations liabilities of harassment. Even an employer with only one employee may be sued for harassment by a current for former employee.

The federal Title VII of the Civil Rights Act, the Illinois Human Rights Act and the Cook County and City of Chicago's Human Rights Ordinances prohibit harassment based upon sex as well as the other protected classifications, such as race, color, national origin, age and disability. Moreover, harassment suits have been filed under the Civil Rights Act of 1866 and state torts of harassment, assault and battery as well as intentional infliction of emotional distress. Although Title VII has a statutory cap on damages at $300,000, there are no damages caps under state laws. Besides the costs of lawsuits, companies

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protein supplement from whey (the watery part of milk remaining after the removal of curds). But the Ratajczaks were not honest. They intentionally used deceitful methods to increase their profits by adding urea to adulterate the protein supplement. Protein levels are extrapolated by measuring nitrogen. By adding urea, rich in nitrogen and used in fertilizers, the protein level would read higher than it actually was. Since urea is cheaper than whey, Packerland saved money and increased its profits. The Ratajczaks were not caught before they were able to sell their business to Packerland Whey Intermediary Holding Co. in May, 2012 for apparently a substantial amount of money. The Ratajczaks continued as employees and, as employees, continued their fraudulent activity.

Things unraveled for the Ratajczaks soon after they sold their business. In November or December 2012, the buyer learned what they had been doing. The Ratajczaks were fired and litigation began. In December, 2012, the Ratajczaks settled for $10 million.

One of Packerland's customers was Land O'Lakes. Land O'Lakes unknowingly purchased the adulterated whey starting in 2006. Although Land O'Lakes developed suspicions about the quality of the whey they were purchasing, they accepted the excuses put forth by the Ratajczaks. But late in 2012, Land O'Lakes stopped buying whey from Packerland and filed suit, claiming a) breach of contract, b) fraud, and c) violation of the Racketeer Influenced and Corrupt Organizations Act (RICO), a claim that could allow Land O'Lakes to claim triple damages and attorneys' fees. Although not stated in the decision, it appears that Land O'Lakes settled its breach of contract claim with Packerland. Land O'Lakes dropped the fraud claim. So Land O'Lakes was left with its RICO claim against the Ratajczaks. This claim had potential insurance coverage that Land O'Lakes tried to tap into.

There were two other claims that Judge Easterbrook had to deal with. In both claims, the Ratajczaks brazenly tried to shift their losses to their insurance carriers.

Claim 1: Land O'Lakes RICO Claim Against the Ratajczaks and Their Insurers

Recall that Land O'Lakes settled their breach of contract claim, apparently against Packerland. But Land O'Lakes wasn't done. It also had its RICO claim against the Ratajczaks which could entitle it to triple damages and attorneys' fees. So a lot was at stake.

The district court granted summary judgment for the insurers and the Ratajczaks, finding that Land O'Lakes failed to prove damages. Judge Easterbrook agreed.

As usual, Judge Easterbrook did not hold back on his view of the claims. He described eight different kinds of damages that Land O'Lakes might have suffered, but apparently did not even assert. For example, it could have claimed lost profits, losses from claims from customers purchasing the adulterated protein, recall expenses, or expenses incurred in investigating Packerland's products. Another way to measure the loss was for Land O'Lakes to purchase retroactive insurance to cover future claims against Land O'Lakes arising from Packerland's fraud. But Land O'Lakes failed to do this or even obtain a quote. Instead of itemizing its damages, Land O'Lakes offered what Judge Easterbrook scathingly referred to as "lawyers' talk."

Perhaps Land O'Lakes was made whole through the settlement on its breach of contract claim and Judge Easterbrook viewed the RICO claim as premature or even as an effort by Land O'Lakes to win a windfall from its misfortune. In any case, Land O'Lakes was stuck with the settlement it had already recovered and lost on its RICO claim.

Claim 2: Ratajczaks Claim Against Packerland's Insurers

Packerland had several insurance policies under which the Ratajczaks were

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additional insureds. But the insurance companies refused to defend or indemnify the Ratajczaks. The insurance policies covered "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." But the Ratajczaks' fraudulent adulteration of Packerland's whey protein concentrate could hardly be described as an "accident." Noted Judge Easterbrook, "Neither the behavior nor the consequence can be called an accident." So the Ratajczaks efforts to shift their loss to Packerland's insurance carrier was not successful.

Claim 3: Ratajczaks Claim Against the Representations and Warranties Insurer

The final claim was the Ratajczaks' claim against the representations and warranties insurer, Beazley Solutions, in the sale of their business. As background, it has become increasingly common to use representations and warranties insurance (R&W insurance) in merger and acquisition transactions. R&W insurance has many advantages to both an acquirer and a seller of a business. The acquirer has more viable recourse against an insurance company for breaches of representations and warranties compared to recourse against a seller, which may have already disposed of the proceeds, or to recourse to an escrow account that involves cumbersome procedures to actually obtain any funds. The seller can have assurance that the proceeds from the sale are secure and can limit or avoid placing any of the proceeds in an escrow account. However, as with any insurance policies, there are limits, requirements to make a claim, and notice procedures. So R&W insurance has some limitations.

The Ratajczaks sued Beazley Solutions to procure R&W insurance in the sale of their business. But, in the end, it provided no benefit to the Ratajczaks.

As noted, in November or December, 2012, only 6 months after the sale of the business, the buyer learned of the Ratajczaks' fraud. Events moved quickly and the Ratajczaks agreed to pay $10 million to the buyer in December, 2012. They then tried to recoup their loss from Beazley Solutions, the insurer. The policy had a $10 million limit with a $1.5 million deductible.

One problem faced by the Ratajczaks was the same one faced in Claim 2. Their loss was not caused by accident or negligence, but by plain fraud. The insurance policy did not cover fraud.

The district court also concluded, and Judge Easterbrook agreed, that even if there was a breach of warranty subject to coverage, the terms of the policy and the agreement would have capped the damages at $1.5 million, matching the deductible that the Ratajczaks would be responsible for anyway.

There was still another reason why Beazley Solutions avoided coverage. It appears that the $10 million settlement and the $10 million limit of coverage was not a coincidence – the Ratajczaks seemed to have assumed the insurance company would step up. But this was a delusion. As explained in the opinion, the insurance company did not receive proper notice of the claim or the settlement. The Ratajczaks notified Beazley Solutions of the claim after the close of business on December 24, 2012. Unstated by the court, but obvious, this was literally the night before Christmas. The settlement was signed on December 28, 2012, after Beazley Solutions asked for more information on the settlement, but before the Ratajczaks bothered to respond. Said Judge Easterbrook, "By cutting Beazley out of the negotiations, the Ratajczaks prevented it from taking steps vital for self-protection."

The Ratajczaks claimed that Wisconsin law requires the insurer to show prejudice to avoid a claim based on inadequate notice. Judge Easterbrook said prejudice could probably be presumed in this situation, but it didn't matter. The policy was controlled by New York law, which permits insurers to insist on controlling settlements.

Facing a loss or claim, it is natural to look for someone else to bear the loss or cover the claim. In fact, insurance is made for this purpose. But these three claims illustrate the difficulties of shifting losses. Land O'Lakes, a victim of fraud, received some recovery although less than it hoped. For the Ratajczaks, the perpetrators of the fraud, Judge Easterbrook and his colleagues on the 7th Circuit, made sure they got what they deserved and did not get what they didn't deserve.

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incur costs in recruitment, retention, lack of succession planning, productivity and efficiency. Therefore, every employer needs to implement an anti-harassment program. The program needs to include the following:

- **Assessment of potential harassment**, by identifying the protected classifications of employees, the prior complaints of harassment as well as current rumors and a review of web-based evaluators, such as Glassdoor;
- **The C-Suite's Commitment** of a corporate culture free of harassment, bullying, fear and inappropriate, non-business related comments and conduct by (a) providing information about the risks and costs, (b) obtaining, distributing and implementing a Statement of Values issued by the board of directors, (c) having members of the C-suite present at training programs and issuing statements confirming the company's values, and (d) holding all levels of supervision accountable for preventing violations of the company's culture and policies;
- **Anti-harassment policy**, including (a) a prohibition of all types of harassment and retaliation for making complaints and participating in investigations, (b) trusted and accessible procedures for making and investigating complaints, (c) an assurance of confidentiality to the extent necessary, and (d) a clear statement that the company will hold violators accountable;
- **Investigation procedures** developed and implemented by human resource professionals, including creating and implementing the proper techniques for (a) conducting investigations, (b) making and implementing management's decision whether a violation of the policy occurred, and (c) documenting the complaints, investigations, decision-making and implementation of remedial action; and
- **Training**, including (a) highlighting and obtaining a new employee's sign-off on the policy during orientation, (b) providing yearly training programs current employees and special programs for supervisors and human resource professional implementing the policy and investigating complaints, and (c) including within the training realistic, company-specific, interactive examples of harassment based upon sex and other protected classification.

By implementing an anti-harassment program, employers may effectively address the real and potential risks of suit, poor morale, turnover and a reputation in the community as a place not to seek employment. ■

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