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1. [Lloyd v. Paine Webber, 1996 U.S. Dist. LEXIS 22628](#)

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Loyd v. Paine Webber

United States District Court for the Southern District of California

October 17, 1996, Decided ; October 18, 1996, Filed

Civil No. 95-1194-BTM(AJB)

Reporter

1996 U.S. Dist. LEXIS 22628 *

JANICE D. LOYD, as Trustee and Liquidator of FIRST ASSURANCE AND CASUALTY COMPANY, LTD.; GUY BURKE, NITA BURKE; DAVID CASTRO and CATHY L. GREEN; on behalf of themselves and all others similarly situated, Plaintiffs, v. PAINE WEBBER, INC., et. al., Defendants.

Disposition: [*1] Plaintiff Janice D. Loyd's claims against Paine Webber dismissed with prejudice; Paine Webber's motion to dismiss Class Plaintiffs' Second, Third, Sixth and Seventh Claims denied; stay on discovery vacated.

Core Terms

misrepresentations, Brokers, Surplus, Lines, Plaintiffs', allegations, motion to dismiss, policyholders, enterprise, policies, insurance company, racketeering

Case Summary

Procedural Posture

Defendants, a corporation and its related parties, filed a motion to dismiss the second amended complaint of plaintiffs, a trustee and class members.

Overview

The class members purchased worthless insurance policies issued by the insurance company. It was a shell corporation intended only for the purpose of issuing worthless insurance policies in order to perpetrate fraud on its policyholders. The trustee and the class members alleged that the corporation made representations about the value of the insurance company's assets to a broker and an insurance producer, who then relied upon the misrepresentations when they sold the insurance to the class members. The trustee and the class members also alleged that the corporation made additional misrepresentations regarding the value of the insurance company's assets to the insurance company's

accountants, who relied on them when they prepared misleading financial statements. The trustee and the class members filed a complaint against the corporation, which was dismissed. They then filed a second amended complaint. The court denied the motion to dismiss, holding that a claim for fraud was pled because the trustee and the class members made a prima facie case that the broker and the insurance producer were their agents and they reasonably relied on the corporation's representations.

Outcome

The court denied the corporation and its related parties' motion to dismiss the trustee and the class members' second amended complaint.

LexisNexis® Headnotes

Civil Procedure > Dismissal > Involuntary Dismissals > General Overview

[HN1](#) [↓] **Dismissal, Involuntary Dismissals**

Dismissal is appropriate under [Fed. R. Civ. P. 12\(b\)\(6\)](#), only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the plaintiffs' allegations.

Insurance Law > Liability & Performance Standards > Disclosure Obligations by Insureds > General Overview

Torts > Business Torts > Fraud & Misrepresentation > General Overview

[HN2](#) [↓] **Liability & Performance Standards,**

Disclosure Obligations by Insureds

In order to state a cause of action for intentional misrepresentation a plaintiff must show (1) a misrepresentation of material fact; (2) knowledge of falsity; (3) intent to induce reliance; (4) justifiable reliance; and (5) resulting damage.

Banking Law > ... > Bank Accounts > Trust Accounts > General Overview

Insurance Law > ... > Insurance Company Operations > Company Representatives > Brokers

Banking Law > Regulators > US Federal Reserve System > Member Banks

Business & Corporate Compliance > ... > Insurance Company Operations > Conducting Business > Surplus Lines Insurers

Insurance Law > ... > Insurance Company Operations > Company Representatives > General Overview

Insurance Law > Types of Insurance > Malpractice & Professional Liability Insurance > Investment Advisers

[HN3](#) **Bank Accounts, Trust Accounts**

Cal. Code Regs. tit. 10, § 2174, titled "Placement of Insurance with Alien Nonadmitted Insurers" sets forth the requirements a surplus lines broker must follow prior to selling insurance from a nonadmitted alien insurance company. Cal. Code Regs. tit. 10, § 2174.9(a)(3), requires a surplus lines broker to submit documentation which demonstrates that an alien nonadmitted insurance company has a minimum of \$ 15,000,000 in capital and surplus. Cal. Code Regs. tit. 10, § 2174.9(a)(4), requires these documents to confirm that a trust account consisting of assets not less than \$ 5,400,000, in a form acceptable under the California Insurance Code, is maintained in a Federal Reserve System member bank.

Criminal Law & Procedure > ... > Racketeering > Racketeer Influenced & Corrupt Organizations Act > General Overview

Criminal Law & Procedure > Criminal Offenses > Racketeering > General Overview

[HN4](#) **Racketeering, Racketeer Influenced & Corrupt Organizations Act**

[18 U.S.C.S. § 1962\(c\)](#), makes it unlawful for any person employed 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. To establish a [§ 1962\(c\)](#) violation, plaintiffs must show conduct of an enterprise through a pattern of racketeering activity that must include at least two racketeering acts.

Criminal Law & Procedure > ... > Racketeering > Racketeer Influenced & Corrupt Organizations Act > General Overview

Criminal Law & Procedure > ... > Discovery & Inspection > Brady Materials > General Overview

[HN5](#) **Racketeering, Racketeer Influenced & Corrupt Organizations Act**

A corporation can be subject to RICO liability for the RICO violations of its employees when it benefits from the RICO violations.

Counsel: For JANICE D LOYD, GUY BURKE, NITA BURKE, DAVID CASTRO, CATHY L GREEN, plaintiffs: Timothy D Cohelan, Cohelan and Khoury, San Diego, CA.

For JANICE D LOYD, plaintiff: Robert L Brace, Hollister and Brace, Santa Barbara, CA.

For PAINE WEBBER INC, defendant: Steven William Hawkins, Munger Tolles and Olson, Los Angeles, CA.

For PAINE WEBBER INC, defendant: Edwain V Woodsome, Jr, Howrey and Simon, Los Angeles, CA.

For AGUILAR & SEBASTINELLI, defendant: Barry Z Brodsky, Peter Q Ezzell, Haight Brown and Bonesteel, Santa Monica, CA.

For INTERNATIONAL CASUALTY AND SURETY COMPANY OF NEW ZEALAND, MARVIN LEWIS, SAMUEL B LOVE, defendants: M James Lorenz, Cannon Parks and Oberhansley, San Diego, CA.

For INTERNATIONAL CASUALTY AND SURETY

COMPANY OF NEW ZEALAND, MARVIN LEWIS, SAMUEL B LOVE, defendants: Michael Jay Barry, Sullivan Hill Lewin Rez and Engel, San Diego, CA.

JESSE J MAYNARD, defendant, Pro se, Overland Park, KS.

For RAY AND ASSOCIATES, defendant: [*2] Alec Mitchell Barinholtz, Ross Dixon and Masback, Irvine, CA.

For SPHERE DRAKE INSURANCE PLC, defendant: Jonathon F Sher, Wilson Elser Moskowitz Edelman and Dicker, Los Angeles, CA.

Judges: HONORABLE BARRY TED MOSKOWITZ, United States District Judge.

Opinion by: BARRY TED MOSKOWITZ

Opinion

MEMORANDUM DECISION AND ORDER GRANTING IN PART AND DENYING IN PART PAINE WEBBER'S MOTION TO DISMISS

This matter came before the Court on Defendant Paine Webber, Inc.'s motion to dismiss Plaintiffs' Second Amended Complaint. The Court finds this matter suitable for submission on the papers without oral argument pursuant to Local Rule 7.1(d)(1). Based on the papers submitted, and for good cause shown, for the reasons stated below, Paine Webber's motion to dismiss is hereby granted in part and denied in part.

PROCEDURAL HISTORY

On July 27, 1995, Janice D. Loyd, as Trustee and Liquidator of First Assurance and Casualty Company, Ltd. ("FACC"), filed a Complaint in this Court ("original Complaint"). The original Complaint was dismissed by order of this Court dated November 21, 1995, with leave to amend. The Court found that Loyd lacked standing to bring the claims in the original Complaint on behalf of FACC. [*3] Loyd subsequently filed an Amended Complaint on December 14, 1995. Four individuals representing a class of defrauded policyholders were added as Plaintiffs along with Loyd in the Amended Complaint. The Amended Complaint was also dismissed with leave to amend by order of this Court dated April 2, 1996. Loyd once again amended her Complaint and filed a Second Amended Complaint. Paine Webber now moves to dismiss the Second Amended Complaint.

PLAINTIFF LOYD

Page one of Plaintiffs' memorandum in opposition to the present motion states: "The causes of action on behalf of Loyd have been included in the Second Amended Complaint so that there can be a final order dismissing her claims in their entirety." The Court finds, for the reasons stated in the order filed April 2, 1996 dismissing Plaintiffs' First Amended Complaint, that Plaintiff Janice D. Loyd as Trustee and Liquidator of FACC does not have standing to pursue claims against Paine Webber. Therefore, all claims in the Second Amended Complaint by Plaintiff Janice D. Loyd against Defendant Paine Webber are hereby dismissed with prejudice.

CLASS PLAINTIFFS

The remaining Plaintiffs in the Second Amended Complaint consist of four individuals [*4] who represent a class of defrauded policyholders. The class consists of purchasers of worthless insurance policies issued by FACC. This Court has consistently found from the allegations in the pleadings that FACC was a shell corporation intended only for the purpose of issuing worthless insurance policies in order to perpetrate a fraud on its policyholders. Although the Second Amended Complaint has deleted references contained in the first two complaints regarding the nature of FACC as a complete fraud, the Court incorporates by reference its previous observation from the pleadings that FACC was never a *bona fide* insurance company, but rather was merely a sham corporation set up and operated exclusively for the purpose of defrauding purchasers of insurance policies. (See Order filed April 2, 1996 at p. 6-7).

The class representatives' claims were dismissed by the April 2, 1996 Order based on: (1) Plaintiffs' failure to set forth any allegations that they or their agents relied on any misrepresentations attributable to Paine Webber; (2) that Plaintiffs' claims of fraud did not identify particular statements which were fraudulent and did not allege with particularity which insurance [*5] producers or surplus lines brokers Paine Webber's employee Craig Aalseth made the allegedly false representations to; and (3) did not identify when or where these statements were made. Plaintiffs were given an opportunity to amend their Complaint to cure these defects, and subsequently filed a Second Amended Complaint. The Second Amended Complaint contains allegations that the policyholders relied on Paine Webber's misrepresentations regarding the value of securities held by Paine Webber for FACC. Plaintiffs cite to

regulations adopted under the California Insurance Code which require surplus lines brokers to file documentation with the California Department of Insurance, before selling policies issued by a non-admitted alien insurance company such as FACC, which indicate that the insurance company has a sum certain on account with a financial institution as security for payment of claims. Plaintiffs contend they relied on Paine Webber's misrepresentation that this sum was held on account with Paine Webber in the form of negotiable securities which satisfied the regulatory requirement. (See Second Amended Complaint P 55).

The Court must accept as true the allegations in the Second [*6] Amended Complaint, construe the facts in the light most favorable to Plaintiffs and draw all reasonable inferences in their favor. *N.L. Industries, Inc. v. Kaplan*, 792 F.2d 896, 898 (9th Cir.1986). [HN1](#) Dismissal is appropriate under *Fed.R.Civ.P. 12(b)(6)* only if it is clear that no relief could be granted under any set of facts that could be proved consistent with Plaintiffs' allegations. *Ascon Properties Inc. v. Mobil Oil Co.*, 866 F.2d 1149, 1152 (9th Cir. 1989).

Paine Webber moves to dismiss the Second Amended Complaint under *Fed.R.Civ.P. 12(b)(6)* and *9(b)*. The Second Amended Complaint contains four causes of action against Paine Webber by the class representatives: violation of the Civil Racketeering and Corrupt Organizations Act (*18 U.S.C. § 1962 (c)* and *(d)*) ("RICO") (Second and Third Claims), intentional misrepresentation (Sixth Claim), and negligent hiring, training and supervision (Seventh Claim).

INTENTIONAL MISREPRESENTATION

Plaintiffs allege that Paine Webber made misrepresentations about the value of FACC's assets to the Surplus Lines Brokers and Retail Insurance Producers, who then relied upon the misrepresentations [*7] when they sold FACC insurance to the policyholders. (FAC P139). Plaintiffs also allege that Paine Webber made additional misrepresentations regarding the value of FACC's assets to FACC's accountants who relied on them when preparing misleading financial statements. Plaintiffs allege these financial statements were relied on by the business and regulatory community which resulted in artificial prolongation of FACC's corporate existence, a concomitant increase in FACC insolvency, and which eventually resulted in the unpaid claims of the insureds. Id.

[HN2](#) In order to state a cause of action for intentional misrepresentation a plaintiff must show (1) a misrepresentation of material fact; (2) knowledge of falsity; (3) intent to induce reliance; (4) justifiable reliance; and (5) resulting damage. *Webster v. Omnitrition Intern., Inc.*, 79 F.3d 776, 788 (9th Cir.1996); *Cicone v. URS Corp.*, 183 Cal. App. 3d 194, 200, 227 Cal. Rptr. 887 (1986). Paine Webber contends plaintiffs have failed to show reliance by either the policyholders or their agents on any alleged misrepresentations. The Second Amended Complaint merely alleges that Paine Webber made the misrepresentations [*8] to third parties such as the Surplus Lines Brokers, the Retail Insurance Producers and FACC's accountants. The Second Amended Complaint does not contain allegations that Paine Webber made misrepresentations directly to the Plaintiffs. Plaintiffs argue that the critical misrepresentation made by Paine Webber upon which the Surplus Lines Brokers and the California Department of Insurance ("CDI") relied was that FACC had enough assets to pay claims made on the policies. (P&A in Opp. at 4). CDI relied on these misrepresentations, allegedly, when it lifted the Cease and Desist Order, and the Surplus Lines Brokers relied on the misrepresentations when they sold the policies. Plaintiffs argue that because the Surplus Lines Brokers and the CDI were acting as agents of the policyholders, their reliance is imputed to the policyholders. (P&A in Opp. at 4).

Paine Webber asserts that the first problem with Plaintiffs' theory of reliance is that the Surplus Lines Brokers are regulated by the CDI. [HN3](#) Title 10 of the California Code of Regulations § 2174 titled "Placement of Insurance with Alien Nonadmitted Insurers" sets forth the requirements a surplus lines broker must follow prior to selling insurance [*9] from a nonadmitted alien insurance company such as FACC. Section 2174.9(a)(3) requires a surplus lines broker to submit documentation which demonstrates that an alien nonadmitted insurance company has a minimum of \$ 15,000,000 in capital and surplus. Section 2174.9(a)(4) requires these documents to confirm that a trust account consisting of assets not less than \$ 5,400,000, in a form acceptable under the California Insurance Code, is maintained in a Federal Reserve System member bank. It is undisputed that Paine Webber, Inc. is not a Federal Reserve System member bank. Plaintiffs respond by stating that the fraud was facilitated because Paine Webber's good name would be relied upon by the CDI and Surplus Lines Brokers notwithstanding technical noncompliance with the newly enacted § 2174.

Paine Webber's argument raises serious questions as to whether plaintiffs' purported agents' reliance was reasonable. However, the court cannot say at this time as a matter of law that the failure to follow Section 2174.9 renders the broker's reliance unreasonable.¹ Conceivably, the brokers and the CDI may have thought that Aalseth's representation was so convincing that technical noncompliance [*10] was harmless. Taking all inferences in favor of plaintiffs, a claim for fraud has been pled. To prevail on a claim for fraud, plaintiffs must make a *prima facie* case that the CDI and the brokers were its agents and they reasonably relied on Aalseth's representations. The allegations in the complaint and the inferences therefrom require the court to deny the motion. However, these issues should receive discovery priority so that they may be addressed under [Fed.R.Civ.P. 56](#) in light of actual facts and not allegations. The motion to dismiss the fraud claim is denied.

NEGLIGENT HIRING TRAINING AND SUPERVISION

Plaintiffs' Seventh Claim in the Second Amended Complaint alleges that Paine Webber negligently hired, trained and supervised defendant Craig Aalseth so that he was able to fraudulently promote the economic viability [*11] of FACC to the detriment of the policyholders. In order for Plaintiffs to bring this claim against Paine Webber, they must show Paine Webber owed them a duty to refrain from negligently hiring, training or supervising its employees. See [Virginia C. v. ABC Unified School District, 15 Cal. App. 4th 1848, 1853 \(1993\)](#). Plaintiffs alleged that the surplus lines brokers and CDI acted as their agents and that Paine Webber's duty of care extended to them. But see [Bily v. Arthur Young and Co., 3 Cal. 4th 370, 397-99, 11 Cal. Rptr. 2d 51, 68, 834 P.2d 745 \(1992\)](#). Plaintiffs have alleged a negligence claim. Whether the brokers and CDI were actually agents of plaintiffs remains to be seen. However, like the issues noted above, dismissal is inappropriate. The court can consider these claims on a factual record on a [Rule 56](#) motion. Therefore, Paine Webber's motion to dismiss is denied.

RICO CLAIMS

Plaintiffs' Second and Third Claims against Paine

Webber are for violations of RICO [sections 1962\(c\)](#) and [\(d\)](#). [HN4](#) [↑] [18 U.S.C. § 1962\(c\)](#) makes it unlawful for any person employed or associated with any enterprise engaged in, or the activities of which affect, [*12] 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. To establish a [§ 1962\(c\)](#) violation, Plaintiffs must show conduct of an enterprise through a pattern of racketeering activity that must include at least two racketeering acts. [Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 496, 87 L. Ed. 2d 346, 105 S. Ct. 3275 \(1985\)](#). Plaintiffs must first establish liability under [§ 1962\(c\)](#), because if there is no liability under [§ 1962\(c\)](#), then there can be no liability under [§ 1962\(d\)](#). [Gilmore v. Berg, 820 F. Supp. 179, 184 \(D.N.J. 1993\)](#)(A plaintiff whose allegations fail to make out a claim under [§ 1962\(a\)\(b\)](#) or [\(c\)](#) cannot make out a claim under [§ 1962\(d\)](#)).

Plaintiffs allege Paine Webber conducted, directed, managed or participated in, either directly or indirectly, the conduct of the affairs and business of the enterprise through a pattern of racketeering activity. (SAC P108). This pattern allegedly entailed controlling the essential California trust account components of the enterprise, mail fraud by Craig Aalseth regarding written [*13] misrepresentations as to the value of FACC's securities, and wire fraud by Aalseth by way of five telephonic misrepresentations to John Smalley of Tradewinds Insurance Co., who was the contact surplus lines broker for FACC.

Paine Webber contends that plaintiffs have failed to state a claim under [18 U.S.C. § 1962\(c\)](#) because they have not shown that Paine Webber's alleged misrepresentation was a "but for" and proximate cause of their injuries as required by [Holmes v. SIPC, 503 U.S. 258, 112 S. Ct. 1311, 117 L. Ed. 2d 532 \(1992\)](#). Plaintiffs allege that "The critical distinction between FACC and other offshore carriers operated by con men in California in the 1990s, which gave FACC the appearance of solvency and legitimacy, was Paine Webber's active participation, direction and control over the financial affairs of FACC and the constant communication of this involvement to the Business and Regulatory Community dealing with FACC". (SAC P53). Also, Plaintiffs allege that Paine Webber benefited from the enterprise. Specifically they allege that "Paine Webber benefitted from its 20-month relationship with FACC, and the Insider RICO Defendants, by receiving substantial sums of money in [*14] the form of fees, interest and commissions. ... and from the exposure of having FACC as a client which was communicated to

¹The court reserves the right to reach that conclusion, if warranted, after the development of a factual record. A decision on this issue is more properly raised in a [Fed.R.Civ.P. 56](#) motion.

the Retail Insurance Producers and Surplus Lines Brokers at monthly marketing meetings attended by Aalseth to induce them to use Paine Webber as the depository of all premiums written by the insurance agents for insurance issued by FACC." (SAC P155).

United States District Judge

End of Document

Plaintiffs urge the Court to reasonably infer from the allegations in the Second Amended Complaint that Aalseth's participation in the alleged RICO scheme was extensive, continuous, systematic, integral and involved Aalseth's control over critical components of the enterprise. This control would then be imputed to Paine Webber through a *respondeat superior* theory of liability. Furthermore, [HN5](#) [↑] a corporation can be subject to RICO liability for the RICO violations of its employees when it benefits from the RICO violations. [Brady v. Dairy Fresh Products, 974 F.2d 1149, 1155 \(9th Cir. 1992\)](#). Taking the allegations of the Second Amended Complaint to be true, and drawing all reasonable inferences in Plaintiffs' favor, Plaintiffs have set forth facts supporting an inference that Paine Webber, through its [*15] employee Aalseth, had a major role in keeping the enterprise alive when the state regulatory agencies were considering the cease and desist orders. Furthermore, the facts alleged support an inference that Aalseth was aware of the fraudulent purpose of FACC. The Court finds that the Plaintiffs have stated a claim under RICO against Paine Webber and that Paine Webber's legal arguments are more properly a subject of a motion for summary judgment. Therefore, Paine Webber's motion to dismiss Plaintiffs' Second and Third Claims in the Second Amended Complaint is DENIED.

CONCLUSION

(1) Plaintiff Janice D. Loyd's claims against Paine Webber are dismissed with prejudice, and this order of dismissal is hereby certified as a final appealable order pursuant to [Fed.R.Civ.P. 54\(b\)](#);

(2) Paine Webber's motion to dismiss the Class Plaintiffs' Second, Third, Sixth and Seventh Claims is denied;

(3) The stay on discovery is vacated. The parties shall arrange to appear before Magistrate Judge Battaglia for an Early Neutral Evaluation and Scheduling Conference.

IT IS SO ORDERED.

DATED: October 17, 1996

HONORABLE BARRY TED MOSKOWITZ