User Name: Robert Brace
Date and Time: Monday, October 11, 2021 12:21:00 PM PDT
Job Number: 155021386

Document (1)

1. *Loyd v. Paine Webber, Inc., 208 F.3d 755*

Client/Matter: -None-
Search Terms: Lloyd v. Paine Webber, Inc. et al., 208 F.3d 755 (9th Cir. 2000).
Search Type: Natural Language
Narrowed by:

Content Type	Narrowed by
Cases	-None-

Loyd v. Paine Webber, Inc.

United States Court of Appeals for the Ninth Circuit

September 14, 1999, Argued and Submitted, Pasadena, California ; March 29, 2000, Filed

No. 98-55113

Reporter
208 F.3d 755 *; 2000 U.S. App. LEXIS 5221 **; 2000 Cal. Daily Op. Service 2458; 2000 Daily Journal DAR 3297

JANICE D. LOYD, as Trustee and Liquidator of First Assurance and Casualty Company, Ltd., Plaintiff-Appellant, v. PAINE WEBBER, INCORPORATED, WELSH AND ASSOCIATES; BONE, ROBERTSON & MCBRIDE; CATANESE INSURANCE SERVICE, aka/CATANESE INSURANCE AGENCY; ATIF K. KAMEL; A.K. INSURANCE SERVICE; KAPLAN AND LAM INSURANCE; DUMAINE INSURANCE SERVICES; DRAPER INSURANCE, aka/E.G. DRAPER INSURANCE, aka/DRAPER INSURANCE; SOUTHERN INSURANCE; SANFORD & GILBERT INSURANCE AGENCY; OMEGA INSURANCE SERVICES; AYLESWORTH INSURANCE; JACK E. GILBERT INSURANCE AGENCY; et al., Defendants, and AGUILAR & SEBASTINELLI, a Professional Law Corporation, Defendant-Appellee.

Prior History: [1]** Appeal from the United States District Court for the Southern District of California. D.C. No. CV-95-01194-BTM. Barry T. Moskowitz, District Judge, Presiding.

Disposition: AFFIRMED.

Core Terms

law firm, malpractice, insiders, allegations, fraudulent, shareholders, fail to state a claim, district court, policies, looted

Case Summary

Procedural Posture
Plaintiff bankruptcy trustee appealed order of United States District Court for Southern District of California which granted defendant law firm's motion to dismiss on alternative grounds that plaintiff had no standing to sue on behalf of sham corporation and that failure to prevent shareholders' fraud stated no legal malpractice claim.

Overview
Plaintiff bankruptcy trustee brought an action against, inter alia, defendant law firm alleging that defendant's failure to prevent the bankrupt company's shareholders from conducting a fraudulent insurance scheme constituted malpractice. The court held that, even though the company was a sham corporation with the sole purpose of perpetrating fraud for its shareholders, the company and thus the trustee had standing to bring the action. As a legally distinct entity which remained liable for the shareholders' fraud, the company sustained injury and the allegation that defendant's conduct assisted the continuation of the fraudulent conduct established causation resulting from the malpractice. However, absent an allegation that defendant knew or should have known of the shareholders' improper conduct, defendant's transmission of false reports from the accountant to the insurance commission was insufficient by itself to raise an inference that defendant had a duty independently to investigate whether the shareholders were engaging in fraud.

Outcome
Order was affirmed; even though plaintiff trustee had standing to bring the malpractice action against defendant law firm on behalf of the bankrupt sham corporation, defendant had no duty to conduct an independent investigation and could not be charged with knowledge of the shareholders' fraud.

LexisNexis® Headnotes

Civil Procedure > Appeals > Standards of Review

HN1[] **Appeals, Standards of Review**

Where the plaintiff is appealing a dismissal pursuant to *Fed. R. Civ. P. 12(b)(6)*, the appellate court takes the allegations in the complaint as true.

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

Insurance Law > Industry Practices > General Overview

HN2 **Company Representatives, Brokers**

Offshore insurance companies are regulated by the California Department of Insurance (Department). They must prove they have sufficient capital to pay potential claims, and must maintain a trust account in the United States. *Cal. Ins. Code § 1765.1(b)(1)*. If the Department is not satisfied with an offshore company's financial status, it may prohibit in-state insurance brokers from selling or promoting the company's policies.

Civil Procedure > Appeals > Standards of Review > De Novo Review

HN3 **Standards of Review, De Novo Review**

Standing to sue is a question of law reviewed de novo.

Civil Procedure > ... > Justiciability > Standing > Injury in Fact

Constitutional Law > ... > Case or Controversy > Standing > General Overview

Civil Procedure > Preliminary Considerations > Justiciability > General Overview

HN4 **Standing, Injury in Fact**

Three elements must be satisfied to meet the minimum constitutional requirements for standing under U.S. Const. art. III: injury in fact, causation, and redressability.

Business & Corporate Law > ... > Corporate Existence, Powers & Purpose > Existence > Distinct & Separate Legal Entity

Civil Procedure > ... > Justiciability > Standing > General Overview

Business & Corporate Law > ... > Corporate Formation > Corporate Existence, Powers & Purpose > General Overview

HN5 **Existence, Distinct & Separate Legal Entity**

A corporation is a distinct legal entity that can sue and be sued separately from its officers, directors, and shareholders. It can be injured even if its sole purpose is to serve as an engine of fraud for its shareholders.

Civil Procedure > ... > Justiciability > Standing > General Overview

HN6 **Justiciability, Standing**

At the pleading stage, general factual allegations of injury resulting from the defendant's conduct may suffice to establish causation for the purpose of standing.

Bankruptcy Law > ... > Bankruptcy > Estate Property > Contents of Estate

Bankruptcy Law > ... > Examiners, Officers & Trustees > Duties & Functions > Reorganizations

Bankruptcy Law > ... > Bankruptcy > Estate Property > Noncustodial Turnovers

HN7 **Estate Property, Contents of Estate**

A trustee may assert claims possessed by the debtor immediately prior to bankruptcy. *11 U.S.C.S. §§ 541*, *542*.

Civil Procedure > Appeals > Standards of Review > De Novo Review

Civil Procedure > ... > Defenses, Demurrers & Objections > Motions to Dismiss > Failure to State Claim

Civil Procedure > Dismissal > Involuntary Dismissals > Failure to State Claims

HN8 **Standards of Review, De Novo Review**

Dismissal for failure to state a claim is reviewed de novo. Review is limited to the contents of the complaint, and all allegations of material fact are taken as true and construed in favor of the nonmoving party.

Civil Procedure > ... > Defenses, Demurrers & Objections > Motions to Dismiss > Failure to State Claim

HN9 **Motions to Dismiss, Failure to State Claim**

A complaint should not be dismissed unless it appears beyond doubt that the plaintiff can prove no set of facts in support of the claim that would entitle her to relief.

Torts > Malpractice & Professional Liability > Attorneys

HN10 **Malpractice & Professional Liability, Attorneys**

The elements of a cause of action for attorney malpractice under California law are: (1) the duty to use such skill, prudence and diligence as members of the profession commonly possess; (2) breach of that duty; (3) a proximate connection between the breach and the injury; and (4) actual loss or damage.

Torts > ... > Elements > Duty > General Overview

HN11 **Elements, Duty**

The question of the existence of a legal duty of care in a given factual situation presents a question of law which is to be determined by the courts alone.

Counsel: Marcus S. Bird, Hollister & Brace, Santa Barbara, California, for the plaintiff-appellant.

Thomas N. Charchut, Haight, Brown & Bonesteel, Santa Monica, California, for the defendant-appellee.

Judges: Before: James R. Browning, Alex Kozinski, and Kim McLane Wardlaw, Circuit Judges.

Opinion

[*757] PER CURIAM:

Janice D. Loyd, trustee and liquidator of First Assurance Casualty Co., Ltd., appeals the district court's dismissal of her complaint against the company's former law firm, Aguilar & Sebastinelli. The complaint charged the firm with malpractice for failing to prevent the company's shareholders from conducting a fraudulent insurance scheme. The district court dismissed the action on the alternative grounds that: (1) the trustee lacked standing to sue; and (2) the complaint failed to state a claim for legal malpractice. We conclude the trustee had standing, but the complaint failed to state a claim for malpractice under California law.

I.

This appeal arises out of an alleged conspiracy to defraud purchasers **[**2]** of First Assurance Casualty's insurance policies. [1] Approximately one year after First Assurance was incorporated in the Turks & Caicos islands, it was acquired by seven individuals (hereinafter "insiders"), who caused the company to sell insurance policies in the United States, mostly in Texas and California.

HN2 Offshore insurance companies are regulated by the California Department of Insurance. They must prove they have sufficient capital to pay potential claims, and must maintain a trust account in the United States. *See* Cal. Ins. Code 1765.1(b)(1). If the Department is not satisfied with an offshore company's financial status, it may prohibit in-state insurance brokers from selling or promoting the company's policies.

The insiders retained Craig Aalseth, an account manager at Paine Webber, to manage **[**3]** the required trust account. Although the company was virtually insolvent, Aalseth prepared reports attesting to its financial viability and compliance with California law. Meanwhile, the insiders were diverting policy premiums into their personal accounts. They permitted the company to pay claims of policyholders only when those claims were small or the claimants threatened to complain to the Department of Insurance.

---

[1] HN1 Because Loyd is appealing a dismissal pursuant to Fed.R.Civ.P. 12(b)(6), the Court takes the allegations in the complaint as true. *See* Pareto v. FDIC, 139 F.3d 696, 699 (9th Cir. 1998).

The company retained Aguilar & Sebastinelli to represent it in state regulatory matters. In March 1991, the Department issued a Cease and Desist Order against the company. The law firm successfully challenged the Order in San Francisco Superior Court, enabling the company to continue to sell policies and collect premiums. Two years later, however, the Department issued a second Cease and Desist Order; shortly thereafter the company declared bankruptcy.

In early 1994, the U.S. Bankruptcy Court for the Western District of Oklahoma appointed Janice Loyd trustee for the company. She filed suit on behalf of the company against the insiders, the insurance **[*758]** brokers who had carried the company's policies, Paine Webber and its employee Craig Aalseth, the company's accountants, **[**4]** and the law firm. The district court dismissed the claim against the law firm on the grounds that the trustee lacked standing to bring a legal malpractice action against the law firm on the corporation's behalf, and, in any event, that the complaint failed to state a claim for legal malpractice.

II.

The district court recognized that, as trustee, Loyd was empowered to bring any claim the company could have brought on its own behalf. However, the court held that the company itself would have lacked standing to sue the law firm because it was a sham corporation with no identity separate from its shareholders. We disagree.

HN3[⬆] Standing to sue is a question of law reviewed de novo. *See* *Byrd v. Guess, 137 F.3d 1126, 1131 (9th Cir. 1998)*. ***HN4***[⬆] Three elements must be satisfied to meet the minimum constitutional requirements for standing under Article III: injury in fact, causation, and redressability. *See*, *e.g.*, *Lujan v. Defenders of Wildlife, 504 U.S. 555, 560-61, 119 L. Ed. 2d 351, 112 S. Ct. 2130 (1992)*; *Warth v. Seldin, 422 U.S. 490, 508, 45 L. Ed. 2d 343, 95 S. Ct. 2197 (1975)*. Redressability is not disputed; the questions are whether **[**5]** the company was injured, and whether the injury was caused by the conduct of the law firm.

The company's status as a "sham" corporation did not preclude it from suffering an injury cognizable under Article III. ***HN5***[⬆] A corporation is a distinct legal entity that can sue and be sued separately from its officers, directors, and shareholders. *See* *Merco Constr. Eng'rs, Inc. v. Municipal Court, 21 Cal. 3d 724, 729-30, 147 Cal. Rptr. 631, 581 P.2d 636 (1978)*. It can be injured even if its sole purpose is to serve as an engine of fraud for its shareholders. Injury is evidenced in this case by the fact that the company remains, to this day, a legally distinct entity that is responsible for the liability it incurred as a result of the allegedly fraudulent actions of its insiders.

The causation element is also satisfied. The complaint alleges that the law firm failed to discover the fraudulent scheme and take action to prevent the insolvent company from continuing to sell insurance in California. [2] This harmed the company by allowing it to incur further liability which it would not otherwise have had. Although this liability exists largely because of the fraudulent conduct of the **[**6]** insiders, the complaint alleges that the period of insolvency was extended, and the company's liability thereby increased, because the law firm helped the company continue to operate. The injury was thus caused, in part, by the allegedly negligent conduct of the law firm. [3]

As a legal entity distinct from its shareholders, the company had a cognizable claim under Article III against the law firm prior to the bankruptcy proceeding. Because **[**7]** ***HN7***[⬆] a trustee may assert claims possessed by the debtor immediately prior to bankruptcy, *see 11 U.S.C. §§ 541*, *542*, Loyd has standing to sue the law firm.

III.

The district court further held that even if the trustee had standing to sue the law firm, the complaint failed to state a **[*759]** claim for legal malpractice. We agree, and affirm the dismissal on this ground.

HN8[⬆] Dismissal for failure to state a claim is reviewed de novo. *See* *Steckman v. Hart Brewing, Inc., 143 F.3d 1293, 1295 (9th Cir. 1998)*. Review is limited to the contents of the complaint, and all allegations of material fact are taken as true and construed in favor of the nonmoving party. *See* *Pareto v. FDIC, 139 F.3d 696, 699 (9th Cir. 1998)*. "***HN9***[⬆] A complaint should not be dismissed unless it appears beyond doubt that the plaintiff can prove no set of facts in support of the claim

---

[2] "***HN6***[⬆] At the pleading stage, general factual allegations of injury resulting from the defendant's conduct may suffice" to establish causation for the purpose of standing. *Lujan, 504 U.S. at 561*.

[3] Our holding that the trustee failed to state a claim for legal malpractice under California law does not undermine this conclusion. The complaint sufficiently alleges that the law firm's conduct was a cause of the injury. Whether this conduct rises to the level of legal malpractice goes to the merits of the lawsuit, not to the preliminary question of standing.

that would entitle [her] to relief." *Tyler v. Cisneros, 136 F.3d 603, 607 (9th Cir. 1998)*.

The trustee made the following allegations:

> . The law firm "provided legal services to [the company] with respect to regulatory and corporate matters, securities and litigation from **[**8]** no later than April of 1991 to March of 1994. At all times material to this case, Aguilar & Sebastinelli held itself out as an expert in the field of offshore insurance. While representing [the company] the law firm also represented other alien insurance companies, most of which were in financial difficulty or were operated by con men for the purpose of looting premiums."
> . "At all times, Aguilar & Sebastinelli knew that [the company] was relying upon Aguilar & Sebastinelli to represent its interests in California as an insurance company, and not the adverse interests of the Insider Rico Defendants who were looting the company of its assets during the time period of Aguilar & Sebastinelli's representation."
> . Aalseth's fraudulent misrepresentation regarding the worth of the company's securities "was communicated directly to Sebastinelli, the attorney for [the company] who, in reliance on the accuracy, transferred the information to CDI in response to request for further information . . ."

. "In performing professional services for [First Assurance Casualty Co.], the attorney firm breached its duty to use the care and skill ordinarily used by reputable attorneys, **[**9]** all to the detriment of FACC in the form of looted premiums and increased insolvency. Said attorney firm breached its duties of loyalty and prudence owed to FACC by allowing the Insider RICO Defendants to act adverse to the interests of FACC and by advising FACC to continue to operate as an insurer in violation of state insurance regulations and at a time when FACC was insolvent and therefore incapable of responding to its contractual obligations."

HN10[↑] The elements of a cause of action for attorney malpractice under California law are: (1) the duty to use such skill, prudence and diligence as members of the profession commonly possess; (2) breach of that duty; (3) a proximate connection between the breach and the injury; and (4) actual loss or damage. *See Wiley v. County of San Diego, 19 Cal. 4th 532, 536, 966 P.2d 983 (1998)*. "***HN11***[↑] The question of the existence of a legal duty of care in a given factual situation presents a question of law which is to be determined by the courts alone." *Nichols v. Keller, 15 Cal. App. 4th 1672, 1682 (1993)*.

The complaint fails to satisfy the duty element. It alleges only that: 1) the law firm relied upon faulty reports provided **[**10]** by Paine Webber and transmitted those documents to the California Department of Insurance; and 2) the firm has represented crooked clients in the past. The trustee contends that these allegations support an inference that the law firm "turned a blind eye to insider misconduct," and "should have known that the company was being looted." However, absent accompanying allegations that the firm knew or should have known the reports were fraudulent, **[*760]** or was aware of other facts suggesting that the company was acting illegally, such an inference cannot be supported. [4]

Alternatively, Loyd argues that these allegations are sufficient to state a claim for malpractice **[**11]** under *FDIC v. O'Melveny & Myers, 969 F.2d 744 (9th Cir. 1992)*, *rev'd on other grounds*, *O'Melveny & Myers v. FDIC, 512 U.S. 79, 129 L. Ed. 2d 67, 114 S. Ct. 2048 (1994)*, *reaff'd on remand*, *FDIC v. O'Melveny & Myers, 61 F.3d 17 (9th Cir. 1995)*. There, we held that in the "high specialty field" of securities offerings, counsel has an automatic duty to "make a 'reasonable, independent investigation to detect and correct false or misleading materials.'" *O'Melveny, 969 F.2d at 749* (quoting *Felts v. National Account Sys. Assoc., Inc., 469 F. Supp. 54, 67 (N.D. Miss. 1978)*. We decline to impose a similar duty here. The *O'Melveny* decision was dependent on the fact that the firm was assisting in a public offering and helped produce documents which suggested to the investing public that the client was financially sound. *See 969 F.2d at 746*. Nowhere did the court indicate that, *as a general matter*, an attorney who represents corporate clients has an automatic duty to independently investigate whether its clients are engaging in fraudulent conduct.

IV.

Although Loyd, as trustee of a corporation **[**12]** whose assets were looted by its shareholders, had standing to sue the law firm, her complaint failed to state a claim for

---

[4] At oral argument, counsel for the trustee asserted that the firm must have been aware of the fraud because it was apparent on the face of the documents submitted to the Department of Insurance. However, this assertion that the documents should have alerted the firm to fraud was absent from the complaint, which the trustee had two opportunities to amend.

legal malpractice under California law. Accordingly, the district court properly dismissed the complaint.

AFFIRMED

End of Document