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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

PRIME PARTNERS IPA OF TEMECULA, INC., a California Corporation, and MEADOWVIEW IPA MEDICAL GROUP, INC., a California Corporation,

Plaintiffs,

v.

KALI P. CHAUDHURI, an individual, HEMET COMMUNITY MEDICAL GROUP, INC., a California corporation; KM STRATEGIC MANAGEMENT, LLC, a California Limited Liability Company, MICHAEL FOUTZ, an individual, WILLIAM E. THOMAS, an individual, and DOES 1 through 100, inclusive,

Defendants.

CASE NO. ED CV-11-01860 ODW (DTBx)

PLAINTIFFS' MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO DEFENDANT KALI P. CHAUDHURI, HEMET COMMUNITY MEDICAL GROUP, INC., AND KM STRATEGIC MANAGEMENT LLC'S MOTION TO DISMISS FIRST AMENDED COMPLAINT

DATE: February 6, 2012
TIME: 1:30 pm
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I. INTRODUCTION

Defendants Kali P. Chaudhuri ("Chaudhuri"), Hemet Community Medical Group, Inc. ("HCMG"), KM Strategic Management, LLC ("KM"), Michael Foutz ("Foutz") and William Thomas ("Thomas") (collectively "Defendants"), working in concert with one another, have engaged in a course of conduct by which they systematically defrauded medical groups with promises of payment for services rendered which they had no intention of making good on, and instead creating false accounting records, forging documents, and engaging in a course of conduct designed to bilk medical groups of money due and owing to them.

Using deceptive means, the defendants have lured doctors and patients away from many of their honest competitors. However, such unfair competition, harmful though it may be, is only a small part of the damage caused by the defendants' wrongful acts. The defendants' fraudulent conduct targets medical groups. The defendants blatantly lie to medical groups about the integrity and reliability of their management services, leaving organizations such as plaintiffs to labor under the false impression that defendants care about the quality of patient treatment and have the best interests of the medical groups and their physicians at heart. Instead, the defendants put the health of California patients at serious risk, by making extortionate demands on plaintiffs and failing to make timely capitation payments to the physicians who render services to those patients, and by cutting off physician's access to patient records. In seeking to line their own pockets at the expense of plaintiffs and their patients, the dishonest acts of the defendants do far more than create an unfair competitive environment for medical groups such as plaintiffs, they also compromise the quality, integrity, and security of medical care to thousands of California patients.

Defendants now attempt to evade responsibility for their dishonest acts, claiming that the First Amended Complaint ("FAC") against them is insufficient to put them on notice of the particulars of the fraud they have committed. This argument is as disingenuous as it is meritless, as is the defendants' baseless contention that their

fraudulent scheme has not directly caused plaintiffs any harm. Plaintiffs' allegations set forth, in great detail, the defendants' longstanding fraudulent scheme to defraud physicians and medical groups, for which defendants must now be held accountable. The defendants' motion to dismiss plaintiffs' FAC is unfounded and should therefore be denied.

II. FACTUAL AND PROCEDURAL BACKGROUND

As alleged in the FAC, defendants historically have acted as the "IPA" or management company for plaintiffs, managing the claims process and payment for services rendered by plaintiffs' physicians. (FAC, ¶ 37). The genesis for the instant action against defendants – as alleged in great detail in the FAC at ¶¶ 37-71 – was the discovery that defendants had been perpetrating a fraud on plaintiffs by, *inter alia*, falsifying accounting records, manipulating the IBNR account, improperly refusing to pay physicians from plaintiffs' own bank accounts managed by defendants, forging a physician's services agreement with Prime Partners, forging physicians' signatures on thousands of letters sent to plaintiffs' patients, and the illegal interference with plaintiffs' right to take their business elsewhere by threatening other IPAs with litigation if they dealt with plaintiffs.

III. ARGUMENT

A. Applicable Standard of Review

In evaluating a defendants' motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6), all facts alleged in the complaint must be accepted as true and construed in the light most favorable to the plaintiff. *Lee v. City of Los Angeles*, 250 F.3d 668, 677 (9th Cir. 2001); *Love v. United States*, 915 F.2d 1242, 1245 (9th Cir. 1989). Rule 12(b)(6) motions are "viewed with disfavor" and "rarely granted." *Hall v. Santa Barbara*, 833 F.2d 1270, 1274 (9th Cir. 1986). Review is based strictly on the contents of the complaint. *Buckey v. County of Los Angeles*, 968 F.2d 791, 794 (9th Cir. 1992). Dismissal is inappropriate "unless it appears beyond doubt that the plaintiff

can prove no set of facts in support of the claim entitling plaintiff to relief." *Livid Holdings Ltd. v. Salomon Smith Barney, Inc*., 416 F.3d 940, 946 (9th Cir. 2005).

B. Plaintiff's Allegations Properly State a RICO Claim Against Defendants

To state a claim under RICO section 1962(c), a party must allege: (1) conduct; (2) of an enterprise; (3) through a pattern; (4) of racketeering activity. *Odom v. Microsoft Corp*., 486 F.3d 541, 547 (9th Cir. 2007). The defendants contend that plaintiffs have failed to plead any of these elements, and that – in addition – plaintiffs have not alleged a proximate causal connection between the acts alleged and the damages plaintiffs suffered. *See* Defendants' Motion, at pp. 10-13. In addition, the defendants suggest that RICO applies exclusively to archetypical organized crime situations, not to illegal conduct of otherwise legitimate companies. For the reasons set forth below, none of these contentions support dismissal of plaintiffs' RICO complaint. Accordingly, the defendants' motion to dismiss plaintiffs' RICO claims should be denied.

1. Plaintiffs Allege a Pattern of Racketeering Activity

Although ¶¶ 21-123 of the FAC describe in intimate detail the background and history of defendants' criminal conspiracy, as well as the manner in which they have engaged in such racketeering since at least 1999, defendants turn a blind eye to those allegations because plaintiffs apparently neglected to use certain buzz words that defendants like, but are entirely unnecessary to show the existence of a "long-term association that exists for criminal purposes." *See H.J., Inc*. 492 U.S. at 242-43.

It is well-settled that a pattern of racketeering activity must consist of at least two separate predicate acts. *See, e.g., Sun Sav. & Loan Ass'n v. Dierdorff*, 825 F.2d 187, 191 (9th Cir. 1987). In determining whether plaintiffs have alleged a pattern of racketeering activity, the court may only consider predicate acts attributable to

defendants. *See Blake v. Dierdorff*, 856 F.2d 1365, 1371 (9th Cir. 1988). Moreover, under RICO, a plaintiff must show that the underlying "racketeering predicates are related, and that they amount to or pose a threat of continued criminal activity." *H. J. Inc.*, 492 U.S. at 239. "'Continuity' is both a closed- and open-ended concept, referring either to a closed period of repeated conduct, or to past conduct that by its nature projects into the future with a threat of repetition." *Id*., at 242.

Plaintiffs herein have satisfied the pattern requirement by alleging that defendants have engaged in a continuing criminal scheme that took shape in September 1999 (FAC, ¶¶ 21-22), and by guiding the court through the details of the defendants' intentional raiding of MedPartners, their defalcation with tens of millions of dollars, their commission of bankruptcy fraud in connection with the bankruptcies of MedPartners, Inland Global Medical Group and Valley Health Systems , respectively, and by providing examples of the current accounting fraud practiced by defendants, not only on the named plaintiffs but on non-party Pacific Heart. In addition, plaintiffs have satisfied the pattern requirement by alleging that defendants have engaged in the widespread forging of signatures on contracts, on letters relating to medical insurance, and on referrals – all of which were transmitted through the mail or electronically and thus constitute predicate acts of mail and wire fraud. These allegations undeniably are sufficient to show an open-ended scheme by defendants which continues to this day, by which defendants seek to deceive and defraud medical groups and physicians throughout Southern California.

Defendants have cited to no case that stands for the proposition that defendants' long-running criminal enterprise has to be directed at all times at plaintiffs in order for a RICO claim to lie, and this argument on its face would conflict with well-established caselaw that courts look to the number of victims as part of their analysis of whether a RICO claim has been stated. Defendants' also, no doubt intentionally, ignore that part of the alleged scheme includes manipulating and withholding the capitation payments to plaintiffs' physicians and falsifying the IBNR reserve pool numbers (FAC, ¶¶ 37, 38,

61-64). Similar allegations have been held sufficient to state RICO claims. *See, e.g., Klay v. Humana, Inc*., 382 F.3d 1241, 1255 (11th Cir. 2004) (affirming RICO class against HMOs for conspiring to defraud physicians of payments due for medical services through use of systemic uniform activities, such as medical necessity requirements, actuarial guidelines, and automated claims systems with adjusted codes and reimbursement rates, all of which were "designed to deny, delay or decrease reimbursement or payment to physicians.").

Contrary to defendants' assertion (Defendants' Motion, p. 7), plaintiffs do in fact contend that defendants' alleged pre-2011 conduct was both "illegal" and "constituted racketeering activity." That plaintiffs herein allege with a greater degree of specificity the predicate acts of mail fraud and wire fraud that caused damages to plaintiffs themselves is in no way intended to imply that defendants have not engaged in such acts routinely since 1999. They undoubtedly have done so, but plaintiffs are not privy to all the details of defendants' criminal conspiracy. Nor need they be in order to allege the conspiracy's existence.

2. Plaintiffs' Damages Were the Direct, Proximate Result of the Defendants' Fraudulent Scheme

Plaintiffs asserting RICO claims under 18 U.S.C. 1964(c) are required to show injury proximately caused by the defendants' RICO violation. *Bridge v. Phoenix Bond & Indemnity Co.*, 128 S. Ct. 2131, 2141-42 (2008); *see also Sedima, S.P.R.L. v. Imrex Co., Inc*., 473 U.S. 479, 496 (1985) (RICO plaintiff "only has standing if ... he has been injured in his business or property by the conduct constituting the violation").

Proximate causation is established where the plaintiff's injuries are "a foreseeable and natural consequence" of the defendant's acts. *Bridge*, 128 S. Ct. at 2144. Proximate cause is "not the same thing as the sole cause." *Oki Semiconductor Co. v. Wells Fargo Bank*, 298 F.3d 768, 773 (9th Cir. 2002). Rather, defendants' conduct is the proximate cause of injury where it is "a substantial factor in the sequence

of responsible causation." *Id.; Trollinger v. Tyson Foods, Inc*., 370 F.3d 602, 615 (6th Cir. 2004) (wrongful conduct must be a "substantial and foreseeable cause"),

As explained below, plaintiffs' have alleged damages directly attributable to the defendants' fraudulent conduct. Plaintiffs' lost income and inability to form contractual relationships with other IPAs was a direct, foreseeable, and natural consequence of the defendants' fraudulent acts. Indeed, the defendants' fraud was specifically calculated to enable defendants to remain plaintiffs' IPA (and wrongfully retain sums due to plaintiffs) despite plaintiffs' unwillingness to remain in such a relationship. Having succeeded in their deceptive scheme, the defendants cannot now claim that they did not cause the very harm they intended.

a. Plaintiffs' Damages Were Proximately Caused by the Defendants' Fraudulent Acts

The defendants perpetuated a fraudulent scheme calculated to lull plaintiffs into believing they had plaintiffs' best interests at heart, while secretly defrauding plaintiffs of monies due to them, mismanaging their practices, spreading rumors in the medical community of their impending failure, attempting to solicit their physicians to move to other competing practices, and impeding plaintiffs' transfer of their management to another IPA by sending cease and desist letters predicated upon a blatant forgery. If plaintiffs had not been led to believing that they could save substantial sums of money by relying on defendants' expertise, plaintiffs never would have contracted with defendants, and would have instead have moved their practices to another IPA. When plaintiffs attempted to do so after uncovering defendants' fraudulent scheme, (FAC, ¶¶ 47-59), defendants by wrongful means (i.e., tortious interference) prevented their departure and attempted to destroy plaintiffs' businesses and lure their physicians to defendants' competing medical groups. (FAC, ¶¶ 60-65)

Defendants argue that plaintiffs' injuries should not be attributed to their fraudulent conduct because plaintiffs fail to allege direct harm, and other factors could

have caused or contributed to the alleged harm. (*See* Defendants' Motion, at pp 14-15. However, imaginary scenarios in which plaintiffs would have suffered the same injuries without the defendants' misconduct cannot absolve them of liability. Proximate cause is "not the same thing as the sole cause." *Oki Semiconductor Co.*, 298 F.3d at 773. The defendants point to nothing in the complaint itself suggesting that proximate cause is not properly alleged. Hypothetical contributing factors extrinsic to the facts alleged does not support a motion to dismiss a complaint. *See Buckey*, 968 F.2d at 794 (review on motion to dismiss restricted to the facts alleged in the complaint).

b. The Policy Concerns Articulated in *Holmes* are Absent Here

In *Holmes v. Securities Investor Protection Corp*., 503 U.S. 258 (1992), the Supreme Court articulated three motivating principles for RICO's proximate causation requirement. First, less direct injuries can make it difficult to ascertain what damages are attributable to the RICO defendants' conduct. *Holmes*, 503 U.S. at 545. Second, undesirably complex rules may be necessary to apportion damages associated with remote injuries. *Id.* Finally, struggling with such damage calculation issues is unnecessary where more direct victims could act as "private attorneys general" to advance RICO's deterrence interests. *Id*. Courts considering causation issues in the RICO context consider these factors when determining whether proximate cause is present. As discussed below, the policy concerns articulated in *Holmes* are not present here.

(1) Plaintiffs Are The Only Victims of the Defendants' Illegal Actions Capable of Pursuing Their Claims

The defendants argue that plaintiffs' injuries could not have been caused by their fraud because many of the misrepresentations alleged were made to other parties. (*See* Defendants' Motion, pp. 19-20) This theory has been unequivocally rejected by the Supreme Court. *See Bridge*, 128 S. Ct. at 2143 (rejecting the erroneous theory that "a

fraudulent misrepresentation can only cause legal injury to those who rely on it").

Nor can these other damaged parties be relied upon to vindicate their own rights. Even if the other IPAs were aware of the fraud being perpetuated against them, and were motivated to act, they would have no damages to claim.[1] Despite the defendants' contentions to the contrary, the mere ability to hire a lawyer does not put one in a position to expose and eradicate wrongdoing. Accordingly, plaintiffs' are the only parties in a position to challenge the defendants' widespread fraud.

(2) Determining Damages Attributable to the Defendants' Conduct Does Not Give Rise to the Concerns Articulated in *Holmes* and *Anza*

The concerns expressed by the *Holmes* Court, and reiterated in *Anza v. Ideal Steel Supply Corp*., 547 U.S. 451 (2006), are not present in this case. Notwithstanding the defendants' contrived exasperation over damage assessment difficulties, no *Holmes/Anza* issues potentially complicating damage apportionment exist here.

In *Anza*, the plaintiff alleged RICO claims against a market competitor for defrauding the New York tax authorities through mail and wire fraud, and using proceeds from the alleged tax fraud to lower prices and attract a larger market share. *Anza*, 547 U.S. at 457-458. The *Anza* Court, applying the principles of *Holmes*, reasoned that because the defendant's total market share was certainly influenced by factors other than the alleged fraud, apportioning damages would require the sort of "complex assessment" the *Holmes* Court warned against. *Id.* at 459. The *Anza* Court also recognized that the immediate victim of the alleged fraud – the State of New York – could be expected to pursue appropriate and straightforward tax fraud remedies, thus obviating the need for complex civil RICO actions concerning that same tax fraud. *Id*. at

[1] Nor can plaintiffs' patients claim any damages at this time. Although the defendants' fraudulent scheme to have elderly patients change insurance carriers have put the integrity, quality, and security of those patients' medical coverage at risk, no legal remedy is available to those patients.

460. Under these circumstances, and in light of the *Holmes* factors, the *Anza* Court found that the connection between plaintiff's alleged harms (lost market share) and defendants' alleged RICO acts (tax fraud) was too attenuated to support relief. *Id*. at 461.

The concerns raised in *Anza* are not present here. First, as explained above, the other IPAs with who plaintiffs sought to contract, unlike the State of New York, have suffered no direct financial harm as a result of their reliance on the defendants' fraud, and thus are unable to pursue any action in connection with that fraud. Conversely, the State of New York regularly prosecutes individuals and companies who commit tax fraud, is obviously capable of doing so again, and has ample motivation to pursue such claims. Further, the fraud alleged in *Anza* was not directed at the plaintiff's customers, but rather at unrelated governmental tax authorities. Unlike the multi-pronged fraud in this case, which was directly aimed at plaintiffs' patients (*e.g*., the 6,600 forged letters), and calculated specifically to disrupt plaintiffs' prospective business relationships with other IPAs (*e.g*., the cease-and-desist letters based on the forged PSA), the alleged fraud in *Anza* was aimed at a municipal entity with no business relationship with any party. Finally, while the injuries alleged in *Anza* related to general market share and the loss of many customers, all of whom certainly have any number of reasons for choosing one competitor's product over another's, the injuries alleged here relate to three specific IPAs (Epic, Prospect, PrimeCare) and to patients who specifically were fraudulently induced into changing their insurance and thus deprived of their right to see their chosen doctors. Calculating damages associated with the failure to enter into a contract, based on misrepresentations made directly to that non-party, will not be onerous or daunting. The defendants' manufactured concerns in this regard are misplaced.

3. Plaintiffs Sufficiently Allege the Existence of an Enterprise

RICO makes it "unlawful for any person employed by 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 or collection of unlawful debt." 18 U.S.C. § 1962(c).

The statute does not define the outer boundaries of the "enterprise" concept but states that the term "includes any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity." § 1961(4). This enumeration of included enterprises is obviously broad, and encompasses "any . . . group of individuals associated in fact." *Id*. The term "any" ensures that the definition has a wide reach, and the very concept of an association is on its face "expansive." *See, e.g.*, *Boyle v. United States*, 556 U.S. 938 (U.S. 2009). In addition, the RICO statute provides that its terms are to be "liberally construed to effectuate its remedial purposes." § 904(a), 84 Stat. 947, note following 18 U.S.C. § 1961; *see also, e.g.,National Organization for Women, Inc. v. Scheidler*, 510 U.S. 249, 257 (1994) ("RICO broadly defines 'enterprise'"); *Sedima, S. P. R. L. v. Imrex Co.*, 473 U.S. 479, 497 (1985) ("RICO is to be read broadly").

Here, defendants' cavil by claiming that while plaintiffs allege that the defendants have formed an "enterprise" (FAC, ¶102), they have failed to provide facts describing the structure of the enterprise, its longevity, its course of conduct, or how defendants conduct the enterprise through their racketeering. (See Defendant's Motion, p. 16). Defendants, again, are wrong on the facts and the law.

Plaintiffs have alleged the existence of the enterprise, detailed at length criminal activities conducted by defendants' enterprise (i.e., the pattern of racketeering activity), specifically noted that the scheme began "in September 1999"and continues through today, and enumerated who the players are. There is no requirement that plaintiffs paint a picture-tree for defendants that shows who the head of the organization is and what the various lieutenants and subordinates do within this criminal enterprise. This argument was rejected out of hand by the Supreme Court, which held that:

> We see no basis in the language of RICO for the structural

> requirements that petitioner asks us to recognize. As we said in *Turkette*, an association-in-fact enterprise is simply a continuing unit that functions with a common purpose. Such a group need not have a hierarchical structure or a "chain of command"; decisions may be made on an ad hoc basis and by any number of methods – by majority vote, consensus, a show of strength, etc. Members of the group need not have fixed roles; different members may perform different roles at different times. The group need not have a name, regular meetings, dues, established rules and regulations, disciplinary procedures, or induction or initiation ceremonies. While the group must function as a continuing unit and remain in existence long enough to pursue a course of conduct, nothing in RICO exempts an enterprise whose associates engage in spurts of activity punctuated by periods of quiescence. Nor is the statute limited to groups whose crimes are sophisticated, diverse, complex, or unique; for example, a group that does nothing but engage in extortion through old-fashioned, unsophisticated, and brutal means may fall squarely within the statute's reach.

Boyle v. United States, 556 U.S. 938 (U.S. 2009).

Defendants' insistence on neat labels whereby plaintiffs identify the structure of the enterprise and each defendant's role within it is not required by RICO, and is simply a head-fake thrown by defendants who cannot see the forest for the trees. All the allegations as to the existence of the criminal enterprise are pled, and well-pled.

4. ___Plaintiffs Have Adequately Pled that Each Defendant Participated in a Pattern and Practice of Racketeering

Plaintiffs have pled not only that each defendant was a member of the criminal enterprise, but also that each defendant was an active participant in the criminal activity that took place. Defendants have not moved to dismiss for lack of particularity, but now in dicta make the argument that insufficient data has been provided about their wrongdoing – i.e., that they need plaintiffs to spell out in greater detail for them how each defendant participated in the wrongs alleged. This argument is unavailing, as plaintiffs have pled that all defendants were active participants in the criminal schemes alleged, and that all of them are agents, co-conspirators, and alter egos of each other. At the pleading stage, plaintiffs are not required to provide defendants with detailed footnotes regarding their wrongful conduct. Plaintiffs more than meet their burden

under Rule 9, and defendants have not formally contested the sufficiency of the FAC on that basis.

5. The Defendants' Implication that RICO is Not Applicable to Commercial Disputes is Without Merit

The defendants' imply that RICO is strictly an organized crime statute that is not appropriate in the context of commercial disputes. However, as the Supreme Court recently observed, the Court has "repeatedly refused to adopt narrowing constructions of RICO in order to make it conform to a preconceived notion of what Congress intended to proscribe." *Bridge*, 128 S. Ct. at 2145.[2] The defendants' narrow view of RICO has been unequivocally rejected by both the Supreme Court and the Ninth Circuit Court of Appeals. *See Sedima*, 473 U.S. at 497-498 ("RICO is to be read broadly" in accordance with "Congress' self-consciously expansive language and overall approach" and "its express admonition that RICO is to 'be liberally construed to effectuate its remedial purposes'"); *Odom*, 486 F.3d at 545-547 (discussing the impropriety of "judicial resistance to RICO, manifested in narrow readings of its provisions by lower federal courts"). The Supreme Court has made abundantly clear that RICO actions are not limited to circumstances popularly associated with archetypical organized crime. *See Sedima*, 473 U.S. at 499 (noting that in enacting RICO, "Congress wanted to reach both 'legitimate' and 'illegitimate' enterprises. The former enjoy neither an inherent incapacity for criminal activity nor immunity from its consequences.")

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[2] *See National Organization for Women, Inc. v. Scheidler*, 510 U.S. 249, 252 (1994) (rejecting the argument that "RICO requires proof that either the racketeering enterprise or the predicate acts of racketeering were motivated by an economic purpose"); *H.J. Inc. v. Northwestern Bell Telephone Co.*, 492 U.S. 229, 244 (1989) (rejecting "the argument for reading an organized crime limitation into RICO's pattern concept"); *Sedima*, 473 U.S. at 481 (rejecting the view that RICO provides a private right of action "only against defendants who have been convicted on criminal charges, and only where there had occurred a 'racketeering injury'").

E. Plaintiffs' Fraud Claims Are Proper

Defendants' intentional misreading of the FAC should simply be disregarded by the Court. Plaintiffs plainly and succinctly allege that they became aware of defendants' fraudulent accounting practices when they discovered a $200,000 discrepancy in accounting records that defendants had provided to them. (FAC, ¶78). This discovery, and the subsequent bogus explanation proffered by defendants when they were caught out in their lie, led to further requests for defendants to supply their historical accounting records to plaintiffs. Contrary to defendants' assertion, plaintiffs allege their "reliance" (FAC, ¶ 94) on the false statements made by defendants to them from 2004 - 2011, and allege that they were unaware of the true facts – i.e., that defendants, who had control of plaintiffs' bank accounts, were stealing their money – because defendants used their resources to conceal that information from plaintiffs. (*Id*.)

With respect to the risk-pool deficits, again, plaintiffs sufficiently plead that they relied on the material misrepresentations and material omissions of defendants to their detriment, as defendants now claim that the risk-pool deficit is underfunded, which is the opposite of what plaintiffs were given to understand from their extended course of dealing with defendants. Plaintiffs have sufficiently pled that defendants committed fraud by affirmative misstatement, material omission, concealment, conspiracy to defraud, and any other variety of deceit that defendants could manufacture in their attempt to harm plaintiffs. The fact that some elements of that fraud also involve defendants' attempts to defraud third-parties does not serve to invalidate the fraud claims as pled.

F. Plaintiffs Conversion Claim is Proper

Plaintiffs' conversion cause of action is not barred by the economic loss rule. The economic loss rule is intended to "prevents the law of contract and the law of torts from dissolving one into the other." *Robinson Helicopter Co., Inc. v. Dana Corp*. (2004) 34 Cal.4th 979, 988. The rule depends on the distinction between commercial transactions

in which economic expectations are protected by commercial and contract law, and transactions with individual consumers who are injured in a manner traditionally addressed through tort law. *Robinson Helicopter*, 34 Cal.4th at 988. "The economic loss rule requires a purchaser to recover in contract for purely economic loss due to disappointed expectations, unless he can demonstrate harm above and beyond a broken contractual promise." *Id*. Accordingly, the economic loss rule will bar a party's claim of tortious breach of contract unless the party alleges tortious behavior independent of the breach of contract. *Id*. at 991.

Nonetheless, a party may allege a tortious breach of contract for intentional acts not ordinarily contemplated by parties entering a contract. "Conduct amounting to a breach of contract becomes tortious only when it also violates a duty independent of the contract arising from principles of tort law." *Erlich v. Menezes* (1999) 21 Cal. 4th 543, 551. "Outside the insurance context, 'a tortious breach of contract . . . may be found when (1) the breach is accompanied by a traditional common law tort, such as fraud or conversion; (2) the means used to breach the contract are tortious, involving deceit or undue coercion or, (3) one party intentionally breaches the contract intending or knowing that such a breach will cause severe, unmitigable harm in the form of mental anguish, personal hardship or substantial consequential damages." *Id*. at 553-54. Focusing on intentional conduct gives substance to the proposition that a breach of contract is tortious only when some independent duty arising from tort law is violated." *Erlich,* 21 Cal.4th at 554.

The California Supreme Court has suggested that, in the absence of the violation of a duty arising under tort law independently of the breach of contract itself, lower courts should limit tort recovery in breach of contract actions to the insurance area. California courts have only permitted tort damages in contract cases in which the tort liability is "either completely independent of the contract"; arises from intentional conduct intended to harm, such as when a breach of duty causes a physical injury; in insurance contract actions involving a breach of the covenant of good faith and fair

dealing; for wrongful discharge in violation of fundamental public policy; or when the plaintiff was fraudulently induced to enter the contract. *Erlich*, 21 Cal.4th at 551-52.

What defendants herein conveniently ignore, however, is that this case involves claims that defendants have breached duties arising under tort independent of the breach of contract itself – to wit, that defendants are fiduciaries whose theft of monies is an independent wrong, above and apart from any cause of action for breach of contract. Given that defendants implicitly admit the sufficiency of the breach of fiduciary duty allegations against them (by failing to contest them), it is surprising that they would ignore this independent basis for the viability of plaintiffs' conversion claim. Moreover, defendant's conveniently elide over that fact that plaintiffs allege that defendants have fraudulently withheld monies due to plaintiffs by means of fraudulent accounting practices designed to hide the fact that defendants were misappropriating funds from plaintiffs' accounts while occupying a trusted position as fiduciaries.

Defendants' cavalier dismissal of plaintiffs' conversion cause of action simply ignores the instruction of *Robinson Helicopter* that "the economic loss rule is designed to limit liability in commercial activities that negligently or inadvertently go awry, not to reward malefactors who affirmatively misrepresent and put people at risk." *Id*. at 991. Per the court, public policy favors an exception to the general rule of enforcing breaches through contract law "when the actions that constitute the breach violate a social policy that merits the imposition of tort remedies." *Id*. at 991-92. Because conversion by a fiduciary coupled with fraud (as practiced by these defendants), is not a socially desirable business practice, permitting plaintiffs' claims for conversion to proceed serves to discourage fraud and deceptive practices in business. The conversion claims should therefore be permitted to go forward. *See, e.g., Robinson Helicopter*, 34 Cal.4th at 992.

G. Rules 8 and 10 Have Been Met

Plaintiffs' 50-page complaint adequately sets out causes of action and the

required predicate facts to put defendants on sufficient notice as to the allegations against them by named plaintiffs in this action. The causes of action are straightforward, and while plain and succinct provide sufficient depth of detail so as not to confuse or hide the allegations made against these defendants. With all due respect, to the extent defendants complain that they are incapable of parsing the allegations against them, their complaints are makeweight and should be disregarded.

H. Leave to Amend Should Be Granted, if Necessary, to Cure Any Pleading Deficiencies

If this Court detects any pleading deficiencies in the FAC, plaintiffs should be granted leave to amend. Such leave is freely and liberally granted as a matter of judicial policy. See Fed. R. Civ. P. 15(a)(2) (court should "freely give leave [to amend] when justice so requires"); *see also Livid Holdings*, 416 F.3d at 946 (dismissal of complaint without leave to amend "is improper unless it is clear that the complaint could not be saved by any amendment").

IV. CONCLUSION

For the foregoing reasons, it is respectfully requested that this Honorable Court deny Defendants' Motion to Dismiss Plaintiffs' First Amended Complaint.

Date: January 17, 2012

CALLAHAN & BLAINE, APLC

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