UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES—GENERAL

Case No. CV-17-1836-MWF (SHKx) **Date: February 27, 2018**
Title: BSA Framing, Inc. v. Applied Underwriters, Inc. et al.

Present: The Honorable MICHAEL W. FITZGERALD, U.S. District Judge

Relief Deputy Clerk:	Court Reporter:
Cheryl Wynn	Not Reported
Attorneys Present for Plaintiff:	**Attorneys Present for Defendant:**
None Present	None Present

Proceedings (In Chambers): ORDER RE: DEFENDANTS APPLIED UNDERWRITERS, INC.; APPLIED UNDERWRITERS CAPTIVE RISK ASSURANCE COMPANY, INC.; CALIFORNIA INSURANCE COMPANY; APPLIED RISK SERVICES, INC.'S OPPOSITION TO FIRMS AMENDED COMPLAINT AND MOTION TO DISMISS AMENDED RICO CLAIMS [36]

On July 11, 2017, Plaintiff BSA Framing, Inc. ("Plaintiff" or "BSA") filed a Complaint against Defendants in the Riverside County Superior Court. In its Complaint, BSA alleged, in addition to several California state law claims, that Defendants Applied Underwriters, Inc. ("AUW"), Applied Underwriters Captive Risk Assurance Company, Inc. ("AUCRA"), California Insurance Company ("CIC"), and Applied Risk Services, Inc. ("ARS") (collectively, the "Applied Defendants") violated the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1962(c),(d). On September 8, 2017, the Applied Defendants removed the case, invoking this Court's federal-question jurisdiction on the basis of BSA's RICO claims.

In an Order dated November 28, 2017 (Docket No. 25), the Court, *inter alia*, granted the Applied Defendants' motion to dismiss with leave to amend with respect to BSA's RICO claims. The Court instructed BSA that, if it wished to pursue its RICO claims in this Court rather than disposing of the RICO claims and proceeding with its state claims in Superior Court, it was to file a memorandum of law in support of its

RICO claims in conjunction with a First Amended Complaint. The Court indicated that the Applied Defendants could respond to BSA's RICO memorandum with a motion to dismiss the RICO claims alone, and that BSA could file a response to the Applied Defendants motion.

On December 11, 2017, BSA filed a First Amended Complaint, in which it again asserts RICO claims against the Applied Defendants (*see* FAC (Docket No. 26)), and a Memorandum of Points and Authorities in Support of First Amended Complaint (the "Memo" (Docket No. 26-3)). On January 16, 2018, the Applied Defendants filed an Opposition to First Amended Complaint and Memorandum of Points and Authorities in Support, and Motion to Dismiss Amended RICO Claims. (the "Motion") (Docket No. 36). On February 5, 2018, BSA filed a Reply to Defendants' Opposition to First Amended Complaint and Memorandum of Points and Authorities in Support, and Motion to Dismiss Amended RICO Claims. (the "Reply") (Docket No. 37).

The Court has read and considered the First Amended Complaint and the papers filed in connection with the Memo, the Motion, and the Reply, and held a hearing on **February 26, 2018**.

For the reasons set forth below, the Motion is **GRANTED *without leave to amend*** as to BSA's RICO claims. The First Amended Complaint fails to plausibly allege the existence of a RICO enterprise. While the FAC's RICO claims may well suffer from other infirmities, the failure to plausibly plead the existence of an enterprise is the most obvious and is independently fatal to the RICO claims. Thus, the Court has no occasion to address the other features of BSA's RICO claims.

The Court orders Defendants to show cause why this action should not be remanded to Superior Court. The response is due on **March 12, 2018**.

I. THE FIRST AMENDED COMPLAINT

The First Amended Complaint contains the following allegations, which the Court accepts as true for present purposes:

A. The Parties and Relevant Non-Parties

Plaintiff BSA is a California corporation with its principal place of business in Riverside, California. (FAC ¶ 9).

Defendant AUW, a Nebraska Corporation with its principal place of business in Omaha, Nebraska, is a "financial service corporation that provides payroll processing services and that solicits and underwrites the sale of workers' compensation insurance through affiliated insurance companies throughout the country." (*Id.* ¶ 10). AUW is the corporate parent of Defendants CIC, AUCRA, and ARS. (*Id.*).

Defendant CIC, a California corporation with its principal place of business in Foster City, California, is a licensed insurance carrier that issues insurance policies, including workers' compensation policies, in California. (*Id.* ¶ 11). "CIC has no employees and all of the actions taken and work performed by CIC [as alleged in the FAC] actually are or were performed by employees of AUW and at the direction of, or with the ratification of AUW." (*Id.*).

Defendant AUCRA is an insurance company incorporated in Iowa with its principal place of business in Omaha, Nebraska. (*Id.* ¶ 12). "AUCRA has no employees and all of the actions taken and work performed by AUCRA [as alleged in the FAC] are and were actually performed by employees of AUW and at the direction of, or with the ratification of AUW." (*Id.*).

Defendant ARS is a Nebraska corporation with its principal place of business in Omaha, Nebraska. (*Id.* ¶ 13). "ARS has no employees and all of the actions taken or work performed by ARS [as alleged in the FAC] actually are or were performed by employees of AUW and at the direction or with the ratification of AUW." (*Id.*).

CIC, AUCRA, and ARS are each subsidiaries of AUW and corporate affiliates of one another. (*Id.* ¶¶ 10-13).

BSA also adds Steven Menzies as a defendant, though has not yet amended the caption to include Menzies. BSA alleges that Menzies is: (1) the President, Treasurer,

and Director of AUW; (2) the President, Chief Executive Officer, and Chief Financial Officer of CIC; (3) the President and Treasurer of AUCRA; and (4) the President, Treasurer, and Director of ARS. (*Id.* ¶ 14). BSA alleges, upon information and belief, that "Menzies owns 11.5% of AUW's parent holding company, AU Holdings, Inc., and personally directed, controlled, supervised, and approved all actions or omissions of AUW, AUCRA, CIC, ARS, [and non-parties] Jeffrey Silver, Sidney Ferenc, Justin N. Smith, and Sean Hughes that are alleged [in the FAC]." (*Id.*).

As discussed further below, BSA alleges that the Applied Defendants and Menzies participated in designing and marketing a workers' compensation insurance package called "EquityComp." (*See id.* ¶ 16).

Non-party Jeffrey Silver is a Nebraska attorney who "has served as General Counsel and an officer of AUW, AUCRA, CIC, and ARS … and as a collection attorney for AUW and AUCRA, when a participant in the EquityComp program fails to pay according to the RPA [Reinsurance Participation Agreement – discussed further below] or promissory notes entered to secure obligations under the RPA." (*Id.* ¶ 19).

Non-parties Sidney Ferenc [spelled "Sydney Ferene" elsewhere in the FAC], Justin N. Smith, and Sean Hughes are inventors of a patent relating to the EquityComp program. (*Id.* ¶¶ 20-22).

Defendant R. David Bulen Insurance Agency (the "Bulen Agency") is a California corporation with its principal place of business in Lake Elsinore, California. (*Id.* ¶ 17). Defendant James Henson is an employee of the Bulen Agency. (*Id.* ¶¶ 18, 347).

B. The EquityComp Program

California law requires that all private employers in California either maintain workers' compensation insurance through an authorized insurer or, with the permission of the Director of Industrial Relations, self-insure. (*Id.* ¶ 24 (citing California Labor Code § 3700)). Pursuant to section 11658 of the California Insurance Code, "[a] workers' compensation insurance policy or endorsement shall not be issued by an

insurer to any person in [California] unless the insurer files a copy of the form or endorsement" with the relevant ratings agency and the Insurance Commissioner. (*Id.* ¶¶ 29, 41 (citing Cal. Ins. Code § 11658)).

AUW began marketing the EquityComp workers' compensation package in 2008, and between 2008 and 2016 sold the package to at least 200 California participants. (*Id.* ¶¶ 66, 67). In BSA's experience, the EquityComp package consists of two primary components: 1) three consecutive one-year workers' compensation insurance policies issued to BSA by CIC, which collectively covered the time period February 20, 2014 through February 20, 2017 (the "Policies"); and 2) a "Reinsurance Participation Agreement" ("RPA") between BSA and AUCRA. (*See id.* ¶¶ 1, 50, 101-105, Exs. 2, 14).

BSA alleges that the RPA constitutes an endorsement to the Policies and thus, under the Insurance Code, had to be filed with the ratings agency and the Insurance Commissioner prior to being issued to any California insureds. (*See id.* ¶¶ 59, 176, 283). BSA alleges that, prior to April 16, 2016, the Applied Defendants purposefully neglected to submit the RPA to the ratings agency and the Insurance Commissioner because they "had concluded that the RPA would be specifically disapproved by the Insurance Commissioner if it were filed because it contains numerous specific provisions that violate California Insurance Law, or that there was a high probability that the RPA would be disapproved for these reasons." (*See id.* ¶¶ 58, 60, 61).

C. The Alleged Deception

The workers' compensation insurance that BSA had in place prior to the EquityComp package was set to expire on February 19, 2014. (*Id.* ¶ 70). BSA thus needed to obtain a new policy effective February 20, 2014 in order to continue lawfully operating in California. (*Id.* ¶¶ 24, 25, 70). On February 17, 2014, ARS, at AUW's behest, transmitted four "marketing documents" to BSA's insurance broker, the Bulen Agency: (1) a five-page document entitled "Workers' Compensation Program Proposal & Rate Quotation" (the "Program Proposal"); (2) a six-page document entitled "Workers' Compensation Program Summary & Scenarios" (the "Program Scenarios");

(3) a one-page document entitled "Producer's Quote Transmittal" (the "Quote"); and (4) a one-page document entitled "Request to Bind Coverages & Services" (the "Request to Bind"). (*Id.* ¶ 71, Exs. 5-8). BSA refers to these four documents collectively as the "Marketing Documents." (*Id.* ¶ 71).

On February 17 or 18, 2014, someone affiliated with the Bulen Agency executed a "Request to Implement Program and Bind Coverage" portion of the Quote on BSA's behalf, and requested expedited service. (*Id.* Ex. 7). On February 18, 2014, the president of BSA executed the Request to Bind, thereby enrolling BSA in the EquityComp program. (*Id.* Ex. 8).

On February 19, 2014, AUW sent the RPA to BSA. (*Id.* ¶ 85, Ex. 14). BSA's president executed the RPA on behalf of BSA on the same day. (*Id.* Ex. 14 at 7). Pursuant to the RPA, BSA "agree[d] to participate in [AUCRA's] segregated protected cell reinsurance program," pursuant to which BSA "may share in the underwriting results of the Workers' Compensation policies of insurance issued from the benefit of [BSA] by the Issuing Insurers [which includes CIC]." (*Id.* Ex. 14 at 1, ¶ 1).

BSA alleges, on information and belief, that "AUW purposefully did not, and it was AUW's practice and procedure not to, provide BSA …, any other potential insured, *or even AUW's own sales representatives*, with a copy of the RPA until the insured had committed to entering the Request to Bind, so that the actual terms and conditions of the RPA would be concealed from a potential insured until after the insured had committed to AUW's program, by executing the Request to Bind, and could not reasonably obtain workers' compensation insurance from any other insurer." (*Id.* ¶ 80) (emphasis in original).

Over the course of its three-year participation in the EquityComp program, BSA paid the Applied Defendants a total of $2,133,344.91 in premiums and the Applied Defendants paid $352,623 in BSA-related claims pursuant to the terms of the Policies and RPA. (*Id.* ¶¶ 128, 221, 247).

BSA alleges that the Program Scenarios document contained certain misrepresentations or omissions that led it to believe that its participation in the EquityComp program would be more financially favorable to BSA than it was.

BSA alleges that the Program Scenarios document is misleading because the "scenario worksheets" within it "contain tables that reflect the final premium that BSA … would be required to pay AUW at certain levels of loss" and "do not contain any indication that BSA … would ever be required to pay any amount in excess of the amounts stated in the Program Scenarios." (*Id.* ¶ 95; *see also id.* ¶¶ 96-100, 194). BSA alleges that it was "justified in concluding and did conclude that the amount that [it] would be required to pay over the life of the [EquityComp] program would be less than or equal to the amounts quoted in the Program Scenarios…" (*Id.* ¶ 197). Specifically, BSA alleges that, based upon the Program Scenarios document, it expected to pay "at least $868,583" less than it actually paid in premiums over the course of its participation in the EquityComp program. (*Id.* ¶ 200). This is apparently so in spite of the following disclaimer that appears on pages 1, 4, 5, and 6 of the six-page document:

> These worksheets are for illustrative purposes only and are based on client provided historical claims data, and should not be construed to amend, modify, or otherwise change the terms of your final Reinsurance Participation Agreement [*i.e.*, the RPA]. The amounts shown are estimates only. Actual amounts will vary depending upon your future payroll and claims, which cannot be determined now with certainty. Each prospective client should review their own information and calculations with their advisor to determine their individual selection of level of risk retention.

(*Id.* Ex. 6 at 1, 4, 5, 6).

BSA also alleges that the Program Scenarios document is misleading because it states that "[o]nly your own individual claims experience is used to determine your final cost and is independent of the claims experience of any other policy holder." (*Id.*

¶¶ 92, 203, Ex. 6 at 2). BSA alleges that this statement is false because, pursuant to the RPA's employment of something called "Exposure Group Adjustment Factors," insureds, "like BSA, for whom losses were very small" are required to pay "a proportionally higher base fee relative to losses" than insureds with "very high losses," who pay "a base fee that is a much smaller proportion of losses." (*Id.* ¶¶ 92, 204, 205). BSA does not explain how insureds who have substantial claims in a given time period paying proportionally less in premiums (*i.e.*, total premiums ÷ total claims) than those with low or no claims is inconsistent with the statement that "only your own individual claims experience is used to determine your final cost and is independent of the claims experience of any other policy holder" (or, for that matter, how it is different than any other insurance policy).

BSA also alleges that it was deceived because "[t]he RPA was not presented together with the Program Scenarios," but that "[e]ven if the RPA were provided with the Program Scenarios…, [it] is purposefully written to be as vague as possible and to obfuscate and hide from any person reading that document the manner in which an insured's payment obligations are to be determined." (*Id.* ¶¶ 195-96) (emphasis in original).

II. PLEADING STANDARDS

"Dismissal under Rule 12(b)(6) is proper when the complaint either (1) lacks a cognizable legal theory or (2) fails to allege sufficient facts to support a cognizable legal theory." *Somers v. Apple, Inc.*, 729 F.3d 953, 959 (9th Cir. 2013). "Federal Rule of Civil Procedure 8(a)(2) requires only 'a short and plain statement of the claim showing that the pleader is entitled to relief,' in order to 'give the defendant fair notice of what the . . . claim is and the grounds upon which it rests . . . ." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007) (quoting *Conley v. Gibson*, 355 U.S. 41, 47 (1957)).

In ruling on the Motion under Rule 12(b)(6), the Court follows *Bell Atlantic* and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009). "To survive a motion to dismiss, a complaint must contain sufficient factual matter . . . to 'state a claim to relief that is plausible on

its face.'" *Iqbal*, 556 U.S. at 678 (quoting *Twombly*, 550 U.S. at 570). The Court must disregard allegations that are legal conclusions, even when disguised as facts. *See id*. at 681 ("It is the conclusory nature of respondent's allegations, rather than their extravagantly fanciful nature, that disentitles them to the presumption of truth."); *Eclectic Properties E., LLC v. Marcus & Millichap Co.*, 751 F.3d 990, 996 (9th Cir. 2014). "Although 'a well-pleaded complaint may proceed even if it strikes a savvy judge that actual proof is improbable,' plaintiffs must include sufficient 'factual enhancement' to cross 'the line between possibility and plausibility.'" *Eclectic Properties*, 751 F.3d at 995 (quoting *Twombly*, 550 U.S. at 556–57) (internal citations omitted).

The Court must then determine whether, based on the allegations that remain and all reasonable inferences that may be drawn therefrom, the complaint alleges a plausible claim for relief. *See Iqbal*, 556 U.S. at 679; *Cafasso, U.S. ex rel. v. Gen. Dynamics C4 Sys., Inc.*, 637 F.3d 1047, 1054 (9th Cir. 2011). "Determining whether a complaint states a plausible claim for relief is 'a context-specific task that requires the reviewing court to draw on its judicial experience and common sense.'" *Ebner v. Fresh, Inc.*, 838 F.3d 958, 963 (9th Cir. 2016) (quoting *Iqbal*, 556 U.S. at 679). Where the facts as pleaded in the complaint indicate that there are two alternative explanations, only one of which would result in liability, "plaintiffs cannot offer allegations that are merely consistent with their favored explanation but are also consistent with the alternative explanation. Something more is needed, such as facts tending to exclude the possibility that the alternative explanation is true, in order to render plaintiffs' allegations plausible." *Eclectic Properties*, 751 F.3d at 996–97; *see also Somers*, 729 F.3d at 960.

Fraud-based allegations are governed by Rule 9(b). "Rule 9(b) demands that, when averments of fraud are made, the circumstances constituting the alleged fraud be specific enough to give defendants notice of the particular misconduct so that they can defend against the charge[.]" *Vess v. Ciba-Geigy Corp. USA*, 317 F.3d 1097, 1106 (9th Cir. 2003) (internal citations omitted). Under Rule 9(b), fraud allegations must include the "time, place, and specific content of the false representations as well as the identities of the parties to the misrepresentations." *Swartz v. KPMG LLP*, 476 F.3d

756, 764 (9th Cir. 2007) (citing *Edwards v. Marin Park, Inc.*, 356 F.3d 1058, 1066 (9th Cir. 2004)). In other words, "[a]verments of fraud must be accompanied by 'the who, what, when, where, and how' of the misconduct charged." *Vess*, 317 F.3d at 1106. Such averments must be specific enough to "give defendants notice of the particular misconduct . . . so that they can defend against the charge and not just deny that they have done anything wrong." *Id*. (quoting *Bly–Magee v. California*, 236 F.3d 1014, 1019 (9th Cir. 2001)).

III. DISCUSSION

Along with the California claims, BSA alleges that the Applied Defendants and Menzies engaged in a pattern of racketeering activity in violation of 18 U.S.C. § 1962(c), and conspired to do the same in violation of 18 U.S.C. § 1962(d). (*See* FAC ¶¶ 126-274).

To state a civil claim for a RICO violation under 18 U.S.C. § 1962(c), a plaintiff must show "(1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity." *Rezner v. Bayerische Hypo-Und Vereinsbank AG*, 630 F.3d 866, 873 (9th Cir. 2010) (quoting *Sedima, S.P.R.L. v. Imrex Co., Inc*., 473 U.S. 479, 496 (1985)). Additionally, in order to have standing to pursue a civil RICO claim, a plaintiff "is required to show that the racketeering activity was both a but-for cause and a proximate cause of his injury." *Id.* (citing *Holmes v. Sec. Investor Prot. Corp.*, 503 U.S. 258, 268 (1992)). "Proximate causation for RICO purposes requires 'some direct relation between the injury asserted and the injurious conduct alleged.'" *Id.* (quoting *Holmes*, 503 U.S. at 268).

The issue here is whether there is a RICO enterprise.

BSA alleges that the Applied Defendants (which BSA refers to as the "Count 1 Defendants" for purposes of its RICO claims), Menzies, and non-parties Jeffrey Silver, Sidney Ferenc, Justin Smith, and Sean Hughes, and other unknown/unnamed employees of the Applied Defendants "formed an association-in-fact enterprise within the meaning of 18 U.S.C. 1961(4) for the purpose of marketing and selling the EquityComp program." (FAC ¶ 131). BSA refers to this alleged enterprise as the

"EquityComp Enterprise." (*Id.*). The Court notes that BSA's allegation in paragraph 131 of the FAC that AUCRA, CIC, and ARS have employees contradicts its allegations in paragraphs 11, 12, and 13 that they have no employees. (*Compare* FAC ¶¶ 11-13 *with* FAC ¶ 131).

The RICO statute defines an "enterprise" as "any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity." 18 U.S.C. § 1961(4). "[T]o establish liability under § 1962(c) one must allege and prove the existence of two distinct entities: (1) a 'person' [which includes business entities under section 1961(3)]; and (2) an 'enterprise' that is not simply the same 'person' referred to by a different name." *Cedric Kushner Promotions, Ltd. v. King*, 533 U.S. 158, 161 (2001). There must therefore be some "distinctness" between the "enterprise" and the individual defendants that are alleged to be the constituent parts of the enterprise. *See id.* at 162-63. Moreover, while the enterprise need not have a "separate structure," it must be alleged separately from the racketeering *activities* it allegedly engaged in, as the enterprise and the activity are "two separate things." *Odom v. Microsoft Corp.*, 486 F.3d 543, 551 (9th Cir. 2007) (citing *U.S. v. Turkette*, 452 U.S. 576, 583 (1981)).

An associated-in-fact enterprise is "a group of persons associated together for a common purpose of engaging in a course of conduct." *U.S. v. Turkette*, 452 U.S. 576, 583 (1981). "To establish the existence of such an enterprise, a plaintiff must provide both 'evidence of an ongoing organization, formal or informal,' and 'evidence that the various associates function as a continuing unit.'" *Odom*, 486 F.3d at 552 (quoting *Turkette*, 452 U.S. at 583). Moreover, RICO liability may only attach to those who "participate in the operation or management of the enterprise itself." *Reves v. Ernst & Young*, 507 U.S. 170, 185 (1993).

A. The alleged parent-subsidiaries enterprise

Without any factual adornment, BSA alleges that "Menzies personally directed, controlled, and managed all activities by AUW." (FAC ¶ 138). AUW, in turn, "directed, controlled, and managed the actions of CIC, AUCRA, and ARS." (*Id.* ¶

139). "AUW was responsible for, and did, actually market and sell the EquityComp program to BSA Framing and other insureds through verbal and written communications, including the Marketing Documents…" (*Id.*). "AUW and Menzies caused ARS to prepare the Marketing Documents that were transmitted to BSA…" (*Id.* ¶ 140). "After ARS prepared the Marketing Documents, AUW would transmit those documents to a potential insured, including BSA Framing…" (*Id.* ¶ 141). "CIC's role in the EquityComp Enterprise was to issue guaranteed-cost policies to BSA Framing and to each other insured in the EquityComp program that, *standing alone* [*i.e.*, un-supplemented by the RPA], were legal guaranteed-cost policies." (*Id.* ¶ 146) (emphasis in original). AUW caused CIC to issue these policies. (*Id.* ¶ 148).

As BSA acknowledges, while the Supreme Court and Ninth Circuit have made no pronouncements on the specific issue, "[o]ther circuits have held that formal legal separation between a parent corporation, like AUW, and subsidiaries, like AUCRA, CIC, and ARS, is insufficient to satisfy the distinctiveness requirement." (Memo at 6). The Court finds the reasoning of those other circuit courts persuasive, particularly in this case, where AUCRA, CIC, and ARS are essentially alleged to be empty shells that are wholly owned and dominated by AUW.

For example, in *Discon, Inc. v. NYNEX Corp.*, the Second Circuit held that three separate corporate entities that "operate within a unified corporate structure" could not constitute a RICO enterprise where they "were acting within the scope of a single corporate structure, guided by a single corporate consciousness." *Discon, Inc. v. NYNEX Corp.*, 93 F.3d 1055, 1064 (2d Cir. 1996), *vacated on other grounds*, 525 U.S. 128 (1998); *see also Cruz v. FX DirectDealer, LLC*, 720 F.3d 115, 121 (2d Cir. 2013) ("FXDD [a subsidiary] and Tradition [the parent company] are alleged to operate as part of a single, unified corporate structure and are, as such, not sufficiently distinct to demonstrate the existence of a RICO enterprise."). In *Bessette v. Avco Financial Services, Inc.*, the First Circuit affirmed the district court's dismissal of a RICO claim and noted that "[i]n most cases, a subsidiary that is under the complete control of the parent company is nothing more than a division of the one entity. Without further allegations, the mere identification of a subsidiary and a parent in a RICO claim fails the distinctiveness requirement." *Bessette v. Avco Financial Services, Inc.*, 230 F.3d

439, 449 (1st Cir. 2000). In *Bucklew v. Hawkins, Ash, Baptie & Co., LLP*, the Seventh Circuit held that there was no enterprise liability where "[t]he claim [was] that the parent stole the software and gave it to the subsidiary to market." *Bucklew v. Hawkins, Ash, Baptie & Co., LLP*, 329 F.3d 923, 934 (7th Cir. 2003) (Posner, J.). "A parent and its wholly owned subsidiaries no more have sufficient distinctness to trigger RICO liability than to trigger liability for conspiring in violation of the Sherman Act …, unless the enterprise's decision to operate through subsidiaries rather than divisions somehow facilitated its unlawful activity, which has not been shown here." *Id.*

BSA alleges that AUCRA, CIC, and ARS have no employees and are essentially operated upon AUW's whims. If there is any scheme, the First Amended Complaint paints a picture of a scheme operated ***by*** AUW ***through*** AUCRA, CIC, and ARS, ***not with*** AUCRA, CIC, and ARS. Therefore, the illicit conduct, if any, is AUW's illicit conduct, not AUW's, AUCRA's, CIC's, and ARS's illicit conduct. BSA argues that, despite the parent-subsidiaries relationship and AUW's alleged domination of that relationship, there is "something more" going on in this case because "AUW necessarily used its subsidiaries to carry out its fraudulent scheme." (Memo at 9). Nowhere in the First Amended Complaint or in BSA's briefing is there any coherent explanation of why AUW could not have provided BSA with allegedly misleading Marketing Documents, withheld the allegedly onerous RPA from insurance regulators, or sprung the RPA on BSA the day after it signed up for the EquityComp package as it is alleged to have done without the aid of subsidiaries.

In sum, the allegations in the First Amended Complaint indicate that the Applied Defendants were "acting within the scope of a single corporate structure, guided by a single corporate consciousness," *Discon*, 93 F.3d at 1064, and thus did not constitute a RICO enterprise.

B. The alleged corporation(s) – employees/officers/agents enterprise

BSA alleges, on information and belief, that "Menzies, Jeffery A. Silver, and Sydney R. Ferene [BSA spells it "Sidney Ferenc" elsewhere in the FAC] all participated in the operation and management of the EquityComp Enterprise as

officers, directors, and shareholders of AUW, AUCRA, CIC, and ARS." (FAC ¶ 158). BSA alleges that Jeffery Silver, an attorney in Nebraska, "operated as the enforcer of the RPA" by bringing collection actions against delinquent insureds.

BSA's position is apparently that anytime a corporation is alleged to have engaged in fraudulent activity, a plaintiff has a viable RICO claim so long as that plaintiff can also allege that the corporation has officers, directors, employees, lawyers, accountants, and/or shareholders that, in ***some*** manner, participated in or benefitted from the alleged fraudulent activity. That theory would ensnare almost every corporation facing a run-of-the-mill fraud claim in RICO litigation and is, unsurprisingly, not the law. *See, e.g., Cruz*, 720 F.3d at 121 ("The requirement of distinctness cannot be evaded by alleging that a corporation has violated the [RICO] statute by conducting an enterprise that consists of itself plus all or some of its officers or employees."); *Riverwoods Chappaqua Corp. v. Marine Midland Bank, N.A.*, 30 F.3d 339, 344 (2d Cir. 1994) ("Because a corporation can only function through its employees and agents, any act of the corporation can be viewed as an act of such an enterprise, and the enterprise is in reality no more than the defendant itself"); *Baumer v. Pachl*, 8 F.3d 1341, 1344 (9th Cir. 1993) (no RICO liability for outside counsel where "he did not play any part in directing the affairs of the enterprise" and his "role was limited to providing legal services to the limited partnership and [corporation]," regardless of whether he rendered those legal services "poorly, properly or improperly"); *Ray v. Spirit Airlines, Inc.*, 836 F.3d 1340, 1357 (11th Cir. 2016) ("In contrast to an individual, a corporation cannot act except through its officers, agents, and employees. Thus, a corporate defendant acting through its officers, agents, and employees is simply a corporation. Labeling it as an enterprise as well would only amount to referring to the corporate 'person' by a different name.") (citing *Cedric Kushner*, 533 U.S. at 161).

C. The alleged corporation(s) – shareholder enterprise

During the hearing, counsel for BSA correctly pointed out that the Court had overlooked its "Count 3" claim for relief, which is a RICO claim against Menzies, a newly added defendant who was served with a Summons and First Amended

Complaint after the Motion was filed and who has yet to answer or otherwise respond to the First Amended Complaint. The Court indicated that it might either: (1) dismiss the "Count 3" RICO claim against Menzies without leave to amend if the rationale for dismissing the RICO claims against the Applied Defendants applies with equal force to Menzies; (2) allow the parties to submit additional briefing on the issue; or (3) allow Menzies to respond the First Amended Complaint himself. Having considered the issue further, the Court opts for the first option.

Citing the Supreme Court's *Cedric Kushner* decision, counsel for BSA suggested that its "Count 3" RICO claim against Menzies should survive dismissal because Menzies, as an alleged 11.5% shareholder of AUW's parent holding company, AU Holdings, Inc., is distinct from the Applied Defendants. In *Cedric Kushner*, the plaintiff, "a corporation that promotes boxing matches," "sued Don King, the president and sole shareholder of Don King Productions, a corporation, claiming that King had conducted the boxing-related affairs of Don King Productions in part through a RICO 'pattern[.]'" *Cedric Kushner*, 533 U.S. at 160. The district court dismissed the complaint on the basis that there was no distinction between the relevant "person" (Don King) and the alleged "enterprise" (Don King Productions), and the Second Circuit affirmed. *Id.* at 161.

The Supreme Court reversed, holding that "the need for two distinct entities [was] satisfied; hence the RICO provision applies when a corporate employee unlawfully conducts the affairs of the corporation of which he is the sole owner – whether he conducts those affairs within the scope, or beyond the scope, of corporate authority." *Id.* at 166. The sole owner of the corporation (Don King) was "the 'person' and the corporation [Don King Productions] [was] the 'enterprise.'" *Id.* at 164. The Supreme Court explicitly distinguished earlier Second Circuit precedent, including *Riverwoods* and *Discon*, which it did not overrule, as those cases "concerned … claim[s] that a corporation was the 'person' and the corporation together with all its employees and agents, were the 'enterprise.'" *Id.*

This action is distinguishable from *Cedric Kushner* in that the corporate defendants (the Applied Defendants) are each alleged to be RICO "persons"

conducting the affairs of a larger "enterprise" (the alleged "EquityComp Enterprise"), and there is a newly-added individual defendant (Menzies) who allegedly serves as an officer of the Applied Defendants and also allegedly happens to own an 11.5% equity stake in AUW's holding company. *See Ray v. Spirit Airlines, Inc.*, 836 F.3d 1340, 1356 (11th Cir. 2016) (noting that the *Cedric Kushner* "Court explicitly disclaimed deciding the 'quite different' issue, arising in this case, where the defendant 'person' is a corporation and is alleged to have engaged in an enterprise with its officers, employees, and agents.") (quoting *Cedric Kushner*, 836 F.3d at 164).

While it is true that in this case Menzies is alleged to be an 11.5% shareholder of AUW's holding company, and in *Cedric Kushner* individual defendant Don King was the 100% shareholder of corporate defendant Don King Productions, the similarities end there. If BSA had alleged that Menzies used his status as an ultimate beneficial owner of AUW to operate AUW as the RICO enterprise, *Cedric Kushner* would be more apposite. But that is not what BSA is alleging. BSA is alleging that AUW, AUCRA, CIC, ARS, Menzies, and nonparties Silver, Ferenc, Smith, and Hughes together constitute the "EquityComp Enterprise" and that Menzies, an officer of AUW, also happens to own shares in AUW's holding company. The fact that a defendant corporate officer holds a direct or indirect ownership stake in a corporate defendant that is alleged to be one of several "persons" engaging in racketeering activity through a larger "enterprise" does not overcome the general principles (discussed above) that a parent corporation and its subsidiaries, or a corporation and its own officers, employees, and agents, are not sufficiently distinct to constitute a RICO enterprise.

A plaintiff cannot plead around the law that a parent corporation and its subsidiaries cannot generally form a RICO enterprise or that a corporation and its officers, employees and agents cannot generally form a RICO enterprise merely by naming a corporate officer as a defendant and alleging that he owns shares in one of the defendant corporations or some other affiliated corporation. To illustrate the point, suppose that Tesla planned to file a RICO lawsuit against Alphabet Inc. (the holding company that owns Google, among other subsidiaries), Google (an Alphabet subsidiary), and Waymo (formerly the Google self-driving car project, and an Alphabet subsidiary) relating to theft of self-driving car technology, and planned to label these

three companies the "Self-Driving Theft Enterprise." Under the law espoused by various circuit courts, including the First, Second, and Seventh Circuits (*see supra*), Tesla would probably not be able to plausibly allege that Alphabet (parent), Google (subsidiary), and Waymo (subsidiary) constitute a RICO enterprise. Nor would Tesla be able to plausibly allege that Alphabet and its officers and employees, Google and its officers and employees, or Waymo and its officers and employees constitute a RICO enterprise. (*See supra*). The principle that a corporation and its own officers cannot constitute a RICO enterprise would extend to Alphabet and Larry Page (Alphabet's CEO), and to Alphabet and Sergey Brin (Alphabet's President). Certainly, Tesla could not evade these principles and convert a losing RICO claim against Alphabet, Google, and Waymo into a winner simply by including Page and Brin as defendants, alleging that they (like many, if not most, officers of a public corporation) own shares in Alphabet, and that Alphabet, Google, and Waymo engaged in racketeering activities through the Self-Driving Theft Enterprise.

In sum, neither the Applied Defendants together, nor the Applied Defendants and their alleged individual officers, employees, and agents, constitute an "enterprise" within the meaning of the RICO statute.

Should BSA be allowed to file a Second Amended Complaint because of Menzies? The only possible amendment under *Cedric Kushner* would be that Menzies was the "person" all along and that AUW was the "enterprise." These allegations would be flatly inconsistent with what BSA chose to allege under Rule 11 in the original Complaint and the First Amended Complaint. Therefore, any further amendment would be futile.

IV. CONCLUSION

For the reasons set forth above, the Motion to Dismiss is **GRANTED *without leave to amend*** as to BSA's RICO claims.

The Court is unaware of any basis for removal other than the RICO claims. The claims are being dismissed at the beginning of the litigation and the entire alleged

scheme deals with the intricacies of California insurance law. As the Court has "dismissed all claims over which it has original jurisdiction," 28 U.S.C. § 1367(c)(3), it is disinclined to exercise supplemental jurisdiction over the remaining state law claims. It is therefore the Court's intention to remand the action to the Riverside County Superior Court.

Defendants are therefore **ORDERED TO SHOW CAUSE**, if any they have, as to why the action should remain in this Court. The response to the OSC, limited to five (5) pages or less, is due by **March 12, 2018**. Plaintiff, if it wishes, may file a reply to the response by **March 19, 2018**.

IT IS SO ORDERED.