PARTIAL OPINION (EDITTED BY RICOACT.COM LLC)

476 F.3d 756, 99 A.F.T.R.2d 2007-974, RICO Bus.Disp.Guide 11,232, 07 Cal. Daily Op. Serv. 1526
(Cite as: 476 F.3d 756)

United States Court of Appeals,
Ninth Circuit.
Theodore C. SWARTZ, Plaintiff-Appellant,
v.
KPMG LLP, Defendant,
and
Presidio Advisory Services Inc.; Deutsche Bank AG; Deutsche Bank Securities, Inc., Defendants-Appellees.

No. 05-35167.
Argued and Submitted Oct. 20, 2006.
Filed Feb. 12, 2007.

PER CURIAM.

I. INTRODUCTION

This suit arises out of a failed tax shelter, which defendants allegedly sold to plaintiff-appellant Theodore Swartz, charging over a million dollars, even though they knew the scheme would be considered unlawful by the IRS. Among the named defendants were accounting firm KPMG, law firm Sidley Austin Brown & Wood ("B & W"), Deutsche Bank AG and Deutsche Bank Securities (collectively "DB" or "Deutsche Bank"), and Presidio Advisory Services ("Presidio"). Against all defendants, Swartz asserted claims (1) under the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1964, (2) under the Washington Consumer Protection Act ("WCPA"), Wash. Rev.Code § 19.86.010 *et seq.*, (3) for common-law fraud, and (4) for civil conspiracy. Swartz also sought a judicial declaration of defendants' liability for interest and penalties that might have arisen during an IRS audit, incomplete at the time he filed his lawsuit. Swartz advanced separate claims against KPMG and B & W for breach of contract, breach of fiduciary duty, and professional malpractice. In a published order,[FN1] the district court dismissed all causes of action against Presidio and DB concluding both that Swartz's complaint failed to state any claims upon which relief could be granted and that it contained insufficient allegations to establish personal jurisdiction.***758** [FN2] Swartz sought leave to cure the substantive and jurisdictional defects in the complaint and to add alternative securities fraud claims. Believing amendment would be futile and that the request was procedurally improper, the district court denied leave to amend. Swartz appeals each of these rulings.[FN3]

FN1. *Swartz v. KPMG,* 401 F.Supp.2d 1146 (W.D.Wash.2004) (*Swartz I*).

FN2. The district court also dismissed many but not all of the claims against the remaining defendants. This appeal concerns only Swartz's claims against Presidio and DB.

FN3. Swartz also argues, for the first time on appeal, that the district court should have taken judicial notice of certain documents attached to his opposition to defendants' motions to dismiss. Because he never presented this argument to the district court and has not demonstrated any exceptional circumstances explaining his silence, we decline to address it here. *See United States v. Oregon,* 769 F.2d 1410, 1414 (9th Cir.1985). We also reject Swartz's invitation to take judicial notice of various documents outside the pleadings. The facts recited in the documents and Swartz's characterization of them are "subject to reasonable dispute" and are therefore not properly noticed. Fed.R.Evid. 201(b).

With the exception of its holding that the allegations in the complaint ruled out "reasonable reliance" as a matter of law, the district court did not err in *Swartz I* and we adopt its decision in large measure. Specifically, we affirm the district court's dismissal with prejudice of the RICO and WCPA claims as well as the request for declaratory relief because each was properly resolved on grounds independent of the reasonable reliance inquiry and because amendment would be futile in each case.

However, we reverse the district court's denial of leave to amend the common-law fraud and conspiracy claims. Whether Swartz could demonstrate reasonable reliance on defendants' alleged misrepresentations was not properly settled as a matter of law under the allegations in the complaint. Furthermore,

even if the original complaint otherwise failed to satisfy the heightened pleading requirements of Federal Rule of Civil Procedure 9(b), it would not have been futile for Swartz to amend. Additionally, although the original complaint failed to allege sufficient jurisdictional facts, Swartz should have been given an opportunity to cure this defect through amendment. Finally, Swartz should have been granted leave to add alternative claims for securities fraud.

II. BACKGROUND

A. Factual Allegations[FN4]

> FN4. Because we are primarily concerned with the sufficiency of Swartz's pleadings, we focus on the allegations in his complaint and take them as true for purposes of this appeal. *See Jackson v. Carey,* 353 F.3d 750, 753 (9th Cir.2003).

In 1999, Swartz sold a business and realized an approximately $18 million gain representing potentially taxable income. KPMG approached Swartz and "lured" him into purchasing a tax-reduction product called BLIPS (Bond Linked Issue Premium Structure), represented as a strategy that would allow Swartz to claim a loss sufficient to offset his capital gain. KMPG advised Swartz of the possibility of an audit, but assured him that KPMG and law firm B & W would provide tax "opinion letters" testifying to the legitimacy of the scheme to the satisfaction of the IRS. According to the complaint, the BLIPS transactions had been devised by KPMG and B & W as a means of charging unwarranted and excessive fees to a " 'select audience' of individuals who had sold large businesses or otherwise incurred large capital gains." Swartz alleged Presidio and DB "were active participants in the conspiracy" and "knew that the series of BLIPS transactions were predetermined steps to generate sham losses for the purpose of ***759** obtaining tax benefits." Swartz further alleged that Presidio and DB knew that KPMG and B & W promoted the BLIPS transactions through the allegedly fraudulent representations outlined above and that the defendants acted in concert and as mutual agents.

In fall 1999, Swartz entered into various BLIPS-related contracts including an "engagement letter," executed September 4, 1999, between himself and KPMG. The letter outlined KPMG's role in the transactions, disclosed that the IRS might question the BLIPS losses, and stated that KPMG "would not guarantee tax results, but would provide that ... there is a greater than 50 percent likelihood ... that [the promised tax benefits] would be upheld if challenged by the[IRS]." Despite this caveat, Swartz alleged that he reasonably relied on KPMG's oral representations that BLIPS would succeed in eliminating his income tax liability.

The transactions comprising the BLIPS strategy occurred between September 30 and December 13, 1999. Because the details are largely irrelevant, they are recounted here in very rough form. KPMG and Presidio facilitated the extension of a multi-million dollar line of credit from DB to Swartz. Swartz created a new limited liability company, Longs Strategic Investment Fund ("Longs"), and engaged Presidio as its manager. The credit facility was contributed to Longs. Longs held various assets including a number of shares of Microsoft common stock. After engaging in two foreign currency transactions intended to give Longs the appearance of a legitimate business, Presidio directed that Longs be dissolved. On December 13, 1999, the company was dissolved and the Microsoft stock was transferred to Swartz as part of his ownership assets.

The intended effect of these transactions was to artificially inflate Swartz's basis in the Microsoft stock so that he could sell it and claim a capital "loss" in the amount of the difference between his inflated basis and the value of the stock. In this case, KPMG represented that "the sale of 364 shares of Microsoft stock would trigger a purported 1999 capital loss of [approximately $18 million]." Swartz paid significant fees to defendants to implement these transactions including a $550,000 management fee to Presidio and more than $800,000 in fees and interest to DB.

According to the complaint, on December 27, 1999, the IRS issued a notice concluding that BLIPS did not produce bona fide losses for income tax purposes. Nevertheless, on December 31, 1999, KPMG and B & W issued opinion letters that purported to confirm the propriety of the scheme.

On August 25, 2000, before Swartz filed his 1999 tax return, his independent tax preparation firm, Moss Adams, questioned the validity of the scheme, informing Swartz it believed the IRS would consider

the BLIPS losses to be improper. On September 5, 2000, the IRS issued an additional notice reiterating its opinion that BLIPS losses were illegitimate and warning that criminal penalties might attach to individuals who attempted to use them on their tax returns. On October 4, KPMG advised Swartz that the promised tax benefits might be disallowed by the IRS. In response, Swartz sought recision of the BLIPS agreements and a monetary refund. The defendants refused. On October 10, Moss Adams resigned from its engagement. KPMG then assisted Swartz in preparing his 1999 return, which reflected deductions for BLIPS "losses."

At some point thereafter, the IRS commenced an audit of Swartz's 1999 tax return.***760** [FN5] Swartz did not amend his 1999 tax return in 2001 or 2002.

> FN5. The IRS had initiated an audit but had not yet disallowed the BLIPS losses at the time Swartz filed his complaint in June 2003. In September 2003, in opposition to defendants' motions to dismiss, Swartz submitted a declaration from his then-current tax attorney indicating that the approximately $17 million loss claimed on Swartz's 1999 tax return had been disallowed. The declaration also indicated that Swartz paid back-taxes and interest. Swartz has not alleged any penalties have been imposed by the IRS.

On February 21, 2002, KPMG informed Swartz that it was under IRS investigation in connection with the BLIPS scheme and that the IRS had announced an amnesty from certain penalties for individual tax filers who disclosed their involvement. KPMG advised Swartz to make a full disclosure to the IRS. B & W sent a similar letter on March 5. The complaint does not indicate whether Swartz took advantage of the IRS initiative.

B. Proceedings Below

On June 6, 2003, Swartz initiated this lawsuit. On February 13, 2004, the district court issued *Swartz I* granting several Federal Rule of Civil Procedure 12(b)(6) motions including Presidio's and DB's. As to each cause of action, the court held there was no conceivable set of facts which could justify relief and dismissed with prejudice. The court also found Swartz had not met his burden of pleading personal jurisdiction and dismissed Presidio and DB from the lawsuit under Rule 12(b)(2). The court added, "[b]ecause [Presidio and DB] were only named in regard[ ] to causes of action which are being dismissed with prejudice, there is no point in permitting plaintiff to amend and plead sufficient jurisdictional facts." *Swartz I*, 401 F.Supp.2d at 1149.

On March 9, 2004, Swartz sought leave to amend. In support, he proposed an amended complaint adding significant detail to the dismissed claims, supplementing the jurisdictional allegations, and adding alternative causes of action for securities fraud under federal and Washington state law. The district court disallowed amendment of the original claims relying on its February 13, 2004 order.[FN6] The court also denied leave to add new securities fraud claims. This appeal followed.

> FN6. Specifically, the district court noted that it had dismissed the original claims with prejudice. The court went on to treat the portion of the motion relating to the dismissed claims as a motion for reconsideration of its February 13, 2004 order. So construed, the motion was time-barred and was otherwise improper. Swartz does not argue that he presented a proper motion for reconsideration. Rather, he argues that he was entitled to amend his complaint notwithstanding the fact that the district court dismissed his claims with prejudice.

III. STANDARD OF REVIEW

A trial court's decision to dismiss for failure to state a claim is reviewed de novo, *Decker v. Advantage Fund, Ltd.*, 362 F.3d 593, 595-96 (9th Cir.2004), as is a dismissal for lack of personal jurisdiction, *Action Embroidery Corp. v. Atl. Embroidery, Inc.*, 368 F.3d 1174, 1177 (9th Cir.2004). Assuming a substantive or jurisdictional defect in the pleadings, "[d]ismissal without leave to amend is proper only if it is clear, upon de novo review, that the complaint could not be saved by any amendment." *McKesson HBOC, Inc. v. N.Y. State Common Ret. Fund, Inc.*, 339 F.3d 1087, 1090 (9th Cir.2003) (quotations, citations omitted).

IV. DISCUSSION

A. The RICO Claim

A civil RICO claim requires allegations of the conduct of an enterprise ***761** through a pattern of racketeering activity that proximately caused injury to the plaintiff. *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 496, 105 S.Ct. 3275, 87 L.Ed.2d 346 (1985). Swartz's RICO claim was predicated on allegations of mail and wire fraud-namely that the marketing and implementation of the BLIPS scheme was carried out through the use of interstate mail and wire communications systems.

The district court dismissed the RICO claim on two alternative grounds. First, the court held the alleged fraud was "in connection with" the sale of the Microsoft stock and could not form the basis of a RICO claim under section 107 of the Private Securities Litigation Reform Act ("PSLRA"), Pub.L. No. 104-67, 109 Stat. 737, 758 (1995). Second, the court held that allegations in the complaint foreclosed a finding of "reasonable reliance"-a necessary element for all species of fraud, including mail/wire fraud.

We agree that the PSLRA bars Swartz's claim and hereby adopt the district court's opinion in *Swartz I* to that extent. *Swartz I*, 401 F.Supp.2d at 1151-52 (Section III. A. 1. "Effect of Private Securities Litigation Reform Act"). Swartz's argument on appeal that the BLIPS transactions were intended to be a swap agreement does not change the fact that the complaint alleges fraud in connection with the sale of securities. Neither was the sale of securities "incidental" to the fraud. The sale of the Microsoft stock was the lynchpin of the BLIPS scheme. The entire purpose of setting up Longs and funding it with the loan proceeds from DB was that, on dissolution, Longs would be able to transfer its assets (the Microsoft stock) to Swartz and his basis in those assets would be artificially inflated by the value of the loan. If Swartz never sold the assets with the inflated basis (the stock) he would never realize the "loss" that he required to offset his real capital gains. As in *SEC v. Zandford*, "the securities sales and [appellees' alleged] fraudulent practices were not independent events." 535 U.S. 813, 820, 122 S.Ct. 1899, 153 L.Ed.2d 1 (2002).

Because the PSLRA bar would apply under any internally consistent set of facts, it would be futile to amend the RICO claim. Consequently, it was not error to dismiss this claim with prejudice. *See Albrecht v. Lund*, 845 F.2d 193, 195 (9th Cir.1988) (if "the allegation of other facts consistent with the challenged pleading could not possibly cure the deficiency, then ... dismissal without leave to amend is proper.") (internal quotation, citation omitted). The reasonable reliance holding is addressed below.

* * * *

V. CONCLUSION

For the foregoing reasons, we affirm the district court's dismissal with prejudice of the RICO, WCPA, and declaratory judgment claims. We also adopt in part the district court's opinion in *Swartz I* as described *supra*. We reverse the denial of leave to amend the common-law fraud and civil conspiracy claims as well as the denial of leave to add statutory securities fraud claims.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED FOR FURTHER PROCEEDINGS CONSISTENT WITH THIS OPINION. APPELLANT TO RECOVER COSTS ON APPEAL.

C.A.9 (Wash.),2007.
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