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8 UNITED STATES DISTRICT COURT  
9 SOUTHERN DISTRICT OF CALIFORNIA

11 UNITED STATES OF AMERICA,

12 Plaintiff,

13 vs.

14 L. DONALD GUESS, et al.,

15 Defendants.

) Case No. 04-CV-2184 LAB (AJB)

) MEMORANDUM OF POINTS AND  
) AUTHORITIES IN SUPPORT OF THE  
) OPPOSITION OF DOCTORS BENEFIT  
) INSURANCE COMPANY, LTD. AND  
) DOCTORS BENEFIT INSURANCE  
) HOLDINGS LTD. TO THE  
) GOVERNMENT'S APPLICATION FOR A  
) PRELIMINARY INJUNCTION,  
) APPOINTMENT OF A RECEIVER AND  
) REPATRIATION OF FOREIGN ASSETS

) Date: December 3, 2004  
) Time: 1:30 p.m.  
) Ctrm: Hon. Larry A. Burns

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I.

**PRELIMINARY STATEMENT**

1  
2  
3 For the past six years, the Internal Revenue Service has been challenging the deductibility  
4 of premiums paid by doctors for supplemental disability insurance purchased from Doctors  
5 Benefit Insurance Company, Ltd. ("DBIC"), and currently has under audit the returns of more than  
6 one hundred doctors who purchased disability insurance from DBIC. In an attempt to bring  
7 closure to the Government's claims that DBIC's supplemental disability insurance is not real  
8 insurance, and therefore that the premiums paid by the doctors' subchapter "C" corporations are  
9 not tax deductible, an action was recently brought in federal district court in Wyoming by an  
10 insured doctor to establish the legitimacy of the deductions of premium payments. *Range & River*  
11 *Radiology, P.C. v. U.S.*, No. 04cv0299 (D. Wy., filed Oct. 21, 2004) ("*Pettinger*") (Gaines Decl.  
12 Exh. DD). In *Pettinger*, now pending before Judge Downes in the United States District Court for  
13 the District of Wyoming, the IRS assessed a deficiency against Range & River Radiology,<sup>1</sup> and  
14 Thomas and Laurie Pettinger for improperly deducting DBIC disability insurance premiums. The  
15 plaintiffs paid the deficiency, exhausted the IRS administrative process with DBIC's assistance,  
16 and filed their complaint in district court. Similarly, in another effort to force the IRS to litigate  
17 and resolve the issue of deductibility, rather than wage a war of attrition against DBIC and its  
18 insured doctors by expensive and disruptive audits, an 11 U.S.C. § 505 action challenging the  
19 Government's claims as a creditor was filed against the IRS in Bankruptcy Court in the xélan  
20 bankruptcy proceedings. Gaines Decl. ¶ 35.

21 Either of these actions would have provided a neutral and expeditious forum for litigating  
22 the appropriateness of the doctors' deductions of premiums paid to DBIC, and would have put to  
23 rest the single issue at stake in the audits. Unwilling to wait for the resolution of these actions, and  
24 in an apparent effort to gain a strategic advantage in this dispute, the Government has brought the  
25 present action, casting DBIC as an illegitimate operation, describing the very doctors who the IRS  
26 is auditing as victims of a fraud – and purporting to bring this action to protect their interests – and

27  
28 <sup>1</sup> This is the only instance that DBIC is aware of where the IRS has actually assessed a  
deficiency against one of its insureds. Gaines Decl. ¶ 34.

1 freezing DBIC's assets so that it cannot operate its business, cannot pay the claims of disabled  
2 doctors, and cannot even pay its lawyers to defend itself.<sup>2</sup> Knowing that it could not secure under  
3 26 U.S.C. § 7402(a) the extraordinary relief requested in its papers, the IRS claims that DBIC is a  
4 Ponzi scheme, and that 18 U.S.C. § 1345 enables it to secure the relief requested. Rather than  
5 produce evidence of the existence of a Ponzi scheme, as none exists, the IRS challenges certain  
6 payments made by DBIC which it claims were inappropriate and constitute the "looting" of DBIC.  
7 As demonstrated in this brief, and the evidentiary support filed with it, DBIC has more than \$500  
8 million in reserves, most of it in Vanguard accounts, to pay claims of its insureds as they arise, and  
9 has more than sufficient assets to pay all current and expected claims of its insureds. Moreover,  
10 the payments the IRS claims constitute "looting" of DBIC's pooled funds were all made for  
11 demonstrably legitimate business purposes.

12 The IRS has made it clear that it does not like the tax-advantaged aspects of the  
13 supplemental disability insurance offered doctors by DBIC. The IRS contends that the product is  
14 not insurance, and therefore premiums paid do not qualify as deductible. But the IRS has been  
15 provided with substantial evidence to the contrary, including: (1) five separate opinions from  
16 respected and independent actuarial firms confirming that the disability insurance offered by  
17 DBIC is insurance; (2) legal opinions from two prominent law firms, opining that the disability  
18 insurance is insurance, and that the premiums may be deducted as ordinary and necessary business  
19 expenses; and (3) A.M. Best's rating of DBIC as an operational insurance company offering  
20 disability insurance. While the IRS is free to challenge these opinions, its effort to do an end run  
21 around the pending federal actions wherein these issues have been presented for adjudication, and  
22 instead create an uneven playing field by shutting DBIC down and drying up the funds for it to  
23 defend itself should not be condoned.<sup>3</sup>

24 \_\_\_\_\_  
25 <sup>2</sup> In line with this strategy, the Tax Division lawyer in charge of this litigation refused to  
26 agree to a modification of the freeze order to permit the payment of DBIC's ordinary operating  
27 expenses, reasonable attorneys' fees, and even the claims of disabled doctors who have been  
28 receiving disability payments under the DBIC insurance policies. Pollack Decl. ¶¶ 2-4.

<sup>3</sup> The same day as the lawsuit was filed, the Department of Justice issued a press release  
publicly describing the disability insurance as a fraudulent tax scheme, asserting that the  
Government has successfully secured injunctions against a number of "tax-scam promoters", and  
suggesting that individuals involved in the program call the receiver to learn how to make a claim.

1 Reduced to its essence, the IRS' claim is that all of the money of the insurance company  
2 should be frozen – notwithstanding that the company would go out of business – because the IRS  
3 **preliminarily** believes (1) that it may be able to prevail in audits of the doctors who purchased  
4 supplemental disability insurance (even though it has only commenced a small percentage of those  
5 audits, and none yet have been litigated); (2) that the doctors "probably" lack other assets with  
6 which to pay any deficiencies which may be assessed; (3) that based on a "guesstimate" as to how  
7 much supplemental disability insurance each doctor bought, the tax deficiency will be \$420  
8 million;<sup>4</sup> and (4) that DBIC will dissipate its funds unless they are frozen. And, in an effort to  
9 bring the case within 18 U.S.C. § 1345 and secure injunctive relief, the Government suggests that  
10 the defendants may be operating a Ponzi scheme, where doctors are induced to pay supplemental  
11 disability insurance premiums to DBIC based on allegedly false representations that those  
12 premiums are tax deductible, and where DBIC's assets are not sufficient to pay the benefits  
13 promised to doctors already in the program.

14 In support of its core theory that the doctors and the IRS have been defrauded by false  
15 representations as to DBIC's disability insurance and the deductibility of premiums, the  
16 Government relies on the opinion of a revenue agent, Mr. Marien, who admittedly is not an expert  
17 on insurance. Mr. Marien opines that while he has not reached any final conclusions, the  
18 preliminary results of his work indicate that the disability insurance offered by DBIC is not  
19 insurance. That supposition is the **central justification** proffered by the Government in all its  
20 papers for freezing the assets of the defendants, and seeking a preliminary injunction.

21 In fact, DBIC and its predecessor, xélan Insurance Company Ltd. (hereinafter collectively  
22 referred to as "DBIC") is, and has been since 1995, a legitimate insurance company providing  
23 supplemental disability insurance to doctors; DBIC's assets have not been dissipated, and are

24 \_\_\_\_\_  
25 Gaines Decl. Exh. CC. This extrajudicial effort to put DBIC out of business, and turn DBIC's  
26 insured doctors against it, is consistent with the IRS' efforts to do an end run around the system in  
27 this proceeding. In both instances, the Government is abusing its power to achieve its ends, and  
circumventing the normal channels of litigation. In so doing, it abridges the due process rights of  
DBIC, the doctors, and others.

28 <sup>4</sup> Even the Government's excessive guesstimate is about \$100 million less than the  
reserves currently in DBIC's accounts. Gaines Decl. ¶ 11.



1 sufficient to meet all current and expected claims under the policies issued; and DBIC's  
2 supplemental disability insurance is in fact insurance, and the premiums are fully deductible. The  
3 evidence presented by the Government establishes **only** that there is a dispute between the IRS on  
4 the one hand, and DBIC and the doctors who purchased supplemental disability insurance from  
5 DBIC on the other, as to whether the premiums paid for the supplemental insurance are  
6 deductible. That dispute will and should be litigated in the two pending lawsuits. The IRS's effort  
7 to turn this dispute into an alleged fraud on the very doctors it is auditing is nothing more than an  
8 attempt to manufacture a basis for injunctive relief, and to drive a wedge between the doctors and  
9 DBIC and destroy DBIC's ability to operate. The extraordinary relief sought by the IRS is clearly  
10 not warranted and should be denied.

11 **II.**

12 **DBIC IS A LEGITIMATE INSURANCE COMPANY AND THE SUPPLEMENTAL**  
13 **DISABILITY INSURANCE OFFERED TO DOCTORS IS INSURANCE.**

14 **A. DBIC IS A LEGITIMATE INSURANCE COMPANY**

15 Since forming in 1995, DBIC and its predecessor, xélan Insurance Company Ltd.,<sup>5</sup> have  
16 written thousands of insurance policies, have paid claims to doctors who have become disabled,  
17 have complied with the regulatory requirements of the Barbados Supervisor of Insurance,  
18 including the annual submission of audited financial statements and an actuarial opinion that the  
19 reserves are sufficient to pay current and expected claims, and have otherwise operated as an  
20 insurance company. DBIC is in good standing with the Barbados Supervisor of Insurance. Gaines  
21 Decl. ¶¶ 4, 6. DBIC's stockholder, Doctors Benefit Insurance Holdings Ltd.,<sup>6</sup> has directed by  
22 resolution that the holding company will operate like a mutual company, with all earnings in  
23

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24 <sup>5</sup> DBIC was incorporated on December 18, 2001 under the Barbados Exempt Insurance  
25 Act 1983-9 under the name xélan Insurance Company (Barbados) Ltd. ("xélan of Barbados").  
26 Gaines Decl. ¶ 5. xélan of Barbados assumed the rights and liabilities of the policies issued by  
27 xélan Insurance Company, Ltd., a British Virgin Islands insurance company ("xélan of BVI"), and  
28 obtained the reserves held for those policies by Assumption Agreement dated March 22, 2002, as  
part of the plan of xélan of BVI to liquidate and dissolve. *Id.* xélan of Barbados changed its name  
to Doctors Benefit Insurance Company, Ltd. on December 5, 2002 *Id.*

<sup>6</sup> Doctors Benefit Insurance Holdings Ltd. is owned by thirteen doctors. It was formerly  
xélan Insurance Holdings Ltd.

1 excess of what is needed for capital, surplus, operational expenses<sup>7</sup> and minimal dividends to be  
2 applied and used for present and future benefits for insureds.<sup>8</sup> *Id.* ¶ 6.

3 A.M. Best Company, the world's oldest and most authoritative insurance rating and  
4 information source, gave DBIC a C+ rating, and stated that its rating outlook was "stable".<sup>9</sup>  
5 Gaines Decl. ¶¶ 7-8. A copy of the rating document evaluating DBIC is attached to the  
6 Declaration of Steven A. Gaines as Exhibit C. In rating DBIC, and thereby confirming that  
7 DBIC's supplemental disability insurance was what it purported to be, A.M. Best analyzed  
8 actuarial reports and interviewed one of DBIC's actuaries about the structure of DBIC's products.  
9 *Id.* ¶ 9. In issuing its rating, A.M. Best was well aware of the structure of the product offered:

10 Since its inception, the company has operated as a niche writer of  
11 individual supplemental health coverages, primarily disability income,  
12 targeting individual and small group practices throughout the United States.  
13 The company presently offers its core products through a very unique  
14 product design, allowing individuals to select a desired premium level and  
15 then backing into a benefit amount. . . .

16 Doctors Benefit sells experience rated group policies, allowing  
17 members to choose their own premium amounts, between \$4,000 and 40%  
18 of net practice income and then Doctors Benefit backs into the benefit level.  
19 There are minimum and maximum benefits offered for "own occupation" or  
20 "any occupation" coverage. Payout is 110% of total premiums paid on Own  
21 Occupation and 400% on Any Occupation/ Catastrophic Benefit disability  
22 claims. Benefits are paid out monthly.

23 Under Doctors Benefit's experience rated policies, participants do  
24 not actually receive dividends, they get an experience adjusted account, and  
25 benefit levels can be increased or reduced based on experience.  
26 Members/policyholders who pay premiums for seven years are eligible to  
27 receive a refund of their account, based on the total premiums paid, less  
28 expenses, benefits payments, and the total experience of the pool.

---

22 <sup>7</sup> DBIC's expense ratios are low for the industry: 6.77% for the year ending  
23 September 30, 2002, 9.45% for the year ending September 30, 2003, and 13.81% for the year  
24 ending September 30, 2004. *See* Farrington Decl. ¶ 8. These expense ratios are considerably  
25 lower than those of other disability insurance companies, whose average expense ratios (the sum  
26 of commissions and expenses) between 1996 and 2000 were in the neighborhood of 30%. *See*  
27 Gaines Declaration Exh. I at 97 (Appendix E-2).

28 <sup>8</sup> A.M. Best has also acknowledged that arrangement. Gaines Decl. ¶ 7 & Exh. C at 14  
29 ("Although Doctors Benefit operates as a stock company, philosophically it is run much like a  
30 mutual, with the majority of available assets reserved for payment of future benefits to its  
31 members.").

<sup>9</sup> A.M. Best downgraded the rating to a D after reading about the current IRS  
32 investigation in DBIC's financial statements. Gaines Decl. ¶ 10.

1 Gaines Decl. Exh. C at 12, 14.

2 This determination by an established, independent and respected rating agency, made after  
3 reviewing DBIC's disability premium and benefit structure and the actuarial opinions with respect  
4 to the product, stands in stark contrast to the declaration of Mr. Marien, who admittedly is not an  
5 expert on insurance companies, is not an actuary, and has not yet reached a final opinion on  
6 whether the disability insurance is in fact insurance. Marien Decl. ¶¶ 17-18.

7 As further evidence that DBIC has operated as a legitimate insurance company, it has  
8 submitted, each year, to the Barbados Supervisor of Insurance, audited financial statements and an  
9 actuarial opinion regarding the sufficiency of its reserves. A copy of the most recent audited  
10 financials, for the year ending September 30, 2003, is attached to the Declaration of Steve Gaines  
11 as Exhibit F. That audit shows assets of \$457,740,161. *Id.* Exh. F at 40. The actuarial opinion  
12 filed with the Supervisor of Insurance shows that DBIC's reserves were more than adequate to  
13 meet present and future expected benefits under all of the insurance policies. Gaines Decl. ¶ 13.  
14 The unaudited financial statements for the year ending September 30, 2004 indicate assets of  
15 \$532,885,103. *Id.* ¶ 11 & Exh. G at 53. While preparations had begun to conduct the audit, it will  
16 be necessary to pay the auditors and actuaries to continue this process, which is not possible  
17 because of the freeze order. *Id.* ¶ 11. **According to the actuarial calculation for the year**  
18 **ending September 30, 2003, if DBIC were to cease business at the time of the audit and all**  
19 **current and expected claims were paid, a reserve balance of in excess of \$47 million would**  
20 **have remained.** *Id.* ¶ 13.

21 Finally, even the U.S. Treasury has treated DBIC as an insurance company. While the IRS  
22 and the Justice Department are arguing that DBIC is not an insurance company, the U.S. Treasury  
23 has accepted millions of dollars in excise taxes from DBIC. DBIC pays those taxes based on its  
24 activities as an off-shore insurance company. For the past two years, DBIC has paid to the United  
25 States Treasury \$8,092,613 in excise taxes and interest on account of its operations as an insurance  
26 company. Farrington Decl. ¶ 7.

27  
28

1 **B. THE SUPPLEMENTAL DISABILITY INSURANCE OFFERED BY DBIC IS**  
2 **INSURANCE, AND WAS DESIGNED TO MEET A NEED OF DOCTORS TO**  
3 **PROTECT THEMSELVES AGAINST THE RISK OF DISABILITY**

4 DBIC has been writing supplemental disability insurance to doctors since the mid 1990's.  
5 At that time, major insurers had cut back dramatically on writing disability insurance to doctors, as  
6 a result of suffering devastating losses incurred by gross miscalculations as to the benefits and  
7 premium structure for disability insurance to doctors. Gaines Decl. ¶ 15. In response to the  
8 reduction in the amount of disability insurance that could be purchased, the supplemental  
9 disability insurance offered by DBIC was developed, and doctors were offered the opportunity to  
10 purchase supplemental insurance up to a total of 40% of their annual practice income. Thus,  
11 doctors could protect their investment in medical school and training against the prospects of  
12 disability, sometimes for a large percentage of their income. *Id.* ¶ 16.

13 The structure of the disability coverage offered by DBIC was designed to guard against the  
14 catastrophic losses suffered by the major insurance companies who had been writing disability  
15 coverage, while at the same time providing doctors meaningful coverage against the risk of  
16 disability. Under the disability policies written by DBIC, a doctor would receive, if disabled in his  
17 own occupation (as a doctor), a minimum of 110% of the premiums paid by him; if disabled for  
18 any occupation, he would receive 400% of the premiums paid. The policy also had a premium  
19 refund feature, similar to that provided by other insurance companies. Generally, if a doctor paid  
20 all of the premiums due for at least seven years, and had no claims under the policy, he could  
21 request an "Experience Adjusted Refund Benefit", and would be entitled to receive a sum equal to  
22 a percentage of the premiums paid, adjusted for gains or losses in the investment of the pooled  
23 funds, and adjusted for claims made by, and forfeitures, surrenders, settlements and mortality of  
24 others who were in the pool. *Id.* ¶ 17.

25 The Government asserts in its memorandum that the "so-called insurance products do not  
26 possess the risk shifting and risk distribution characteristics that are necessary to any program of  
27 insurance. Instead, the premiums operate primarily as savings and investment vehicles, payments  
28

1 for which are not deductible in calculating taxable income."<sup>10</sup> Government's Memo at 9. **This is**  
2 **the heart of the Government's case—that the product offered by DBIC is not insurance, and**  
3 **that DBIC has defrauded the doctors by representing that premiums to pay for the**  
4 **insurance are tax deductible, and has defrauded the United States by providing the doctors**  
5 **with a vehicle that allows them to avoid paying taxes on income.**

6 The Government acknowledges, as it must, that premiums for disability coverage are  
7 deductible. The nub is whether the disability insurance offered by DBIC is insurance, and the  
8 Government says it is not because it lacks risk shifting and risk distribution attributes. What is  
9 remarkable is that **the only evidence** proffered by the Government to support this central assertion  
10 is the declaration of John L. Marien. Mr. Marien is neither an expert on insurance, nor an  
11 actuary—he assists agents in matters dealing with employee welfare benefit plans. Marien Decl.  
12 ¶ 2. **Mr. Marien does not opine that the supplemental disability insurance is not insurance.**  
13 Rather, he states that he has not reviewed all of the relevant information with which to render an  
14 opinion, and then asserts that the "preliminary results of [his] work indicate" that the supplemental  
15 disability insurance is not insurance, because it lacks the attributes of risk shifting and risk  
16 distribution. Then, based on these "preliminary" indications, he asserts that Guess's statements to  
17 the contrary "are false and misleading." Marien Decl. ¶ 18.

18 That is the essence of the Government's case for injunctive relief. Based on the  
19 preliminary indications of the work of a non-expert, predicated on admittedly incomplete  
20 information, the representations made to the doctors and the IRS that the disability insurance is  
21 insurance are false and misleading. From that preliminary indication, the Government concludes  
22 that the premiums operate in reality as savings and investment vehicles, even though, as it  
23 inconsistently acknowledges, the premiums are pooled and not kept separate from the general  
24 liabilities of the company (risk distribution), are not subject to the control of the participants (risk  
25 shifting), and are utilized to pay benefits, expenses and costs of defense, expenditures that would  
26

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27 <sup>10</sup> The widely accepted test for determining whether insurance qualifies as such for  
28 federal tax purposes is whether there is risk-shifting and risk-distributing. *Helvering v. Le Gierse*,  
312 U.S. 531, 539 (1941).

1 be made by any insurance company.

2 In and of itself, Mr. Marien's declaration is not sufficient to warrant the issuance of  
3 injunctive relief. In addition, however, DBIC has presented substantial evidence that the disability  
4 insurance is in fact insurance. Thus, in contrast to Mr. Marien's unsupported "preliminary  
5 indications," five actuarial reports prepared by respected, independent actuarial firms confirm that  
6 DBIC's program meets the risk-shifting and distribution requirements of insurance. Attached as  
7 Exhibits K through O to the Declaration of Steve Gaines are copies of the reports of each of the  
8 five actuarial firms. For example, Ralph J. Sayre, who certified that he had no economic interest  
9 in the outcome of his analysis, concluded in his detailed actuarial opinion rendered on April 23,  
10 2003 that DBIC's policy "transfers the insured's risk of loss of earnings resulting from a reduced  
11 capacity to work to the insurance company" and that "the [DBIC] policies provide pooling of  
12 risk." Gaines Decl. Exh. K at 111, 112. David Wilson of Niis/Apex prepared an actuarial model  
13 for DBIC's product on September 4, 2001, and concluded that "there is adequate risk transfer in  
14 the Policy to constitute legitimate insurance." *Id.* Exh. L at 146.

15 Additionally, the tax implications of DBIC's policies were analyzed by two reputable law  
16 firms, Eckert Seamans Cherin & Mellott, and Williams Coulson.<sup>11</sup> The lawyers at these firms  
17 principally responsible for the opinions, Tom Roberts and Michael E. Lloyd, each opined that  
18 DBIC's disability insurance constitutes insurance and that the premiums are deductible by DBIC's  
19 insureds. Examples of recent opinion letters issued by Williams Coulson and Eckert Seamans and  
20 signed by Messrs. Roberts and Lloyd confirm that DBIC's disability insurance program constitutes  
21 insurance for tax purposes. Gaines Decl. ¶ 20. Finally, as previously noted, A.M. Best reviewed  
22 DBIC's supplemental disability insurance and rated it as insurance. *Id.* ¶ 10.

23 Perhaps sensing that the supplemental disability insurance offered by DBIC will be  
24 determined to be insurance, Mr. Marien hedges his bet and states that even if DBIC's policies are  
25 insurance, some undetermined portion of the doctors' premiums are not deductible, because  
26 U.S.C. § 419 renders deductible only the "qualified cost" of an insurance plan. Marien Decl. ¶ 16.

27 \_\_\_\_\_  
28 <sup>11</sup> Copies of the descriptions of each of these law firms from their web sites are attached  
to the Gaines declaration as Exhibit P.

1 That is, if the true cost of the insurance benefits to be provided is smaller than the cost of the  
2 premiums, only the portion of the premiums constituting the true cost of coverage is deductible.  
3 Mr. Marien opines that "the only way that xélan can conceivably assert that the alleged premiums  
4 bear a relationship to the cost of the actual disability insurance is if there is a very high likelihood  
5 that participating doctors will become disabled." *Id.* ¶ 19a.

6 In fact, DBIC's actuarial model assumes that there is a high likelihood that the participating  
7 doctors would become disabled. That model was supported by the actuaries rendering opinions.  
8 When one of those actuaries was interviewed by the IRS, he stated that his independent analysis  
9 had confirmed that 80% disability was a reasonable assumption for the medical professionals  
10 insured by DBIC. Gaines Decl. ¶ 21 & Exh. S. Indeed, Mr. Robinson did a separate study in  
11 2002 which validated that figure. *Id.* ¶ 22 & Ex. T. Moreover, even if there were an issue as to  
12 the amount of the premium that were deductible, that issue has not even been raised, much less  
13 litigated, by the IRS in any proceeding, and the uncertainty of how it would be resolved, much less  
14 the quantification of the numbers, renders the relief sought here inappropriate.

15 **C. CAPTIVE INSURANCE COMPANIES ARE COMMONLY USED IN THE**  
16 **INSURANCE INDUSTRY**

17 The Government suggests that there is something improper in the relationship between  
18 xélan and DBIC: "xélan's outside independent CPA has described DBIC as a 'captive' insurance  
19 company of xélan . . . DBIC is owned (directly or indirectly) by xélan doctors, [and] DBIC will  
20 'sell' insurance products only to doctors who belong to xélan." France Decl. ¶ 10. Contrary to the  
21 Government's suggestion, however, there is nothing improper with a company's operation as a  
22 'captive' insurance company. A captive is "a special type of insurance company set up by a parent  
23 company, trade association, or group of companies to insure the risks of its owner or owners."  
24 Gaines Decl. Exh. U at 243

25 Captive insurance companies and other alternative risk transfer arrangements arose in the  
26 United States in the 1980s when it became more difficult for individual businesses to obtain  
27  
28

1 certain types of insurance coverage.<sup>12</sup> Currently, roughly 40% to 50% of all commercial insurance  
2 is written through captives. *Id.* Exh. V at 250. Some of the world's most well respected  
3 companies, including Morgan Stanley, J.P. Morgan, MasterCard and Viacom have captive  
4 insurers. *Id.* Exh U at 243-44.

5 "An association [may] form a captive to provide insurance coverage. Professionals –  
6 doctors, lawyers, accountants – have formed many captives over the years." *Id.* at 248. DBIC was  
7 formed to provide supplemental disability insurance to doctors who were members of xélan, the  
8 Economic Association of Health Professionals (the "Association"). Given the circumstances of its  
9 formation, it is expected that DBIC would be owned by several members of that Association. Nor  
10 is it unusual that DBIC will only sell its products to the members of the Association – the so-  
11 called "xélan doctors" it was created to serve.

12 The Government has also alleged that individuals associated with xélan, in particular Don  
13 Guess and Les Buck, have some kind of control over DBIC, and that in particular, Dr. Guess  
14 "controls DBIC funds", because xélan Investment Services ("XIS"), owned by Guess, is under  
15 contract to provide investment advisory services to DBIC. France Decl. ¶ 82. That individuals  
16 involved with xélan are also involved with DBIC is to be expected, since DBIC was formed to  
17 provide disability insurance to doctors who were members of the Association. However, the  
18 Government has presented no evidence that either Dr. Guess or Mr. Buck have any ownership or  
19 other active relationship with DBIC. From a review of the relevant records, Dr. Guess was never a  
20 shareholder of DBIC's holding company, and never served as a director or officer of DBIC.  
21 Gaines Decl. ¶¶ 26, 36. Mr. Buck was actively involved in the operations of DBIC, but he  
22 resigned as a director in June, 2004 and sold his stock in September, 2004. Gaines Decl. ¶ 26, 36.

23 Since the meeting of shareholders of the holding company in June, 2004, the directors  
24 responsible for the operation of DBIC are Tom Roberts, Monte Mellon and Chris Evans.  
25 Financial decisions of DBIC are made by the board of directors. Dr. Guess does not, contrary to

26 \_\_\_\_\_  
27 <sup>12</sup> The formation of captives was facilitated by Congress in 1981 when it passed the  
28 Product Liability Risk Retention Act. Gaines Decl. Exh. U at 243. In 2002 alone, a record 462  
captives were formed, resulting in a total of 4,526 active captives. *Id.* at 248. Barbados is the 6th  
largest captive market in the world. *Id.* at 244-45.



1 the Government's assertion, have "control over DBIC's money" by reason of the investment  
2 advisory contract between DBIC and xélan Insurance Services ("XIS"). That contract merely  
3 provides that XIS is to provide investment advisory services with respect to the company's  
4 managed funds. It is terminable at any time by DBIC upon notice. Gaines Decl. ¶ 27 & Exh. X at  
5 256. Many if not most insurance companies have similar agreements with outside investment  
6 advisors. *Id.* ¶ 27. The services XIS is authorized to perform are to review basic investment  
7 concepts, determine investment profiles, assist in identifying investments that are consistent with  
8 those profiles, provide periodic reviews and reports, and initiate trades on behalf of DBIC. *Id.*  
9 ¶ 27 & Exh. X at 256. This routine investment advisory agreement does not constitute control of  
10 DBIC or its funds.

### 11 III.

#### 12 **DBIC IS NOT OPERATING AS A "PONZI" SCHEME**

##### 13 A. **DBIC HAS SUFFICIENT FUNDS TO SATISFY ALL OBLIGATIONS TO ITS** 14 **POLICYHOLDERS**

15 Contrary to the Government's assertions, the doctors' funds are not at risk and there is no  
16 basis for the issuance of the extraordinary relief it seeks. To make out its case for extraordinary  
17 relief, the Government asserts that misrepresentations were made to the doctors to induce them to  
18 purchase insurance from DBIC, and that the funds thereby secured were misused for personal gain  
19 pursuant to a Ponzi scheme. France Decl. ¶ 31. "[A] Ponzi scheme is a phony investment plan in  
20 which monies paid by later investors are used to pay artificially high returns to the initial  
21 investors, with the goal of attracting more investors." *In re Bonham*, 229 F.3d 750, 759 n.1 (9th  
22 Cir. 2000). An entity operating as a Ponzi scheme, by definition, does not have sufficient assets  
23 with which to meet its current obligations, and relies on influxes of new capital to meet those  
24 obligations.

25 The Government alleges that because funds to pay certain expenses were transferred to  
26 Jacquot's trust account, the value of the remaining pooled funds could not be sufficient to cover  
27 the payouts promised to DBIC's clients. France Decl. ¶ 30. Based on this, France concludes that  
28 DBIC is operating a Ponzi scheme and that "unless a restraining order is issued and a receiver

1 appointed over these funds, the doctors who have paid money into the DBIC programs will lose  
2 some or all of those funds." *Id.* ¶ 31.

3 Mr. France admits that his conclusions are based on incomplete information. France Decl.  
4 ¶ 31. In fact, DBIC has always maintained sufficient capital and assets to satisfy the claims of  
5 existing investors, and it has not dissipated assets. First, DBIC has complied with the requirement  
6 that it file yearly with the Supervisor of Insurance of Barbados audited financial statements and an  
7 actuarial opinion stating that the reserves of the company are sufficient to pay all present and  
8 expected future claims of policyholders. Attached to the declaration of Steve Gaines as Exhibit F  
9 are the financials for the most recent year for which audited financial statements are available, the  
10 year ending September 30, 2003. **The actuarial calculation indicates that if all current and**  
11 **expected claims were paid, a balance of approximately \$47 million in reserves, along with**  
12 **capital and surplus of approximately \$2.3 million, would remain.** Gaines Decl. ¶ 13.

13 In addition, the unaudited financial statements for the year ending September 30, 2004  
14 reflect assets of \$532,885,103. *Id.* ¶ 11. While the actuarial opinion for this year has not been  
15 finalized, **the draft schedule for an actuarial opinion, based on the unaudited numbers,**  
16 **reflects that if business ceased at that point, there are sufficient funds to pay all current and**  
17 **future expected claims, and still have approximately \$11 million remaining in additional**  
18 **reserves, as well as capital and surplus of \$2.1 million..** *Id.* ¶ 14.

19 Moreover, even if there were a rescission of all policies issued to current DBIC insureds,  
20 and all premiums paid by those insureds were to be returned to them, **DBIC has sufficient assets**  
21 **to cover all premium contributions attributable to current insureds, with a substantial**  
22 **surplus remaining.** Patton Decl. ¶¶ 16-18.

23 Contrary to Mr. France's "guess," the financial statements of DBIC, along with the  
24 actuarial opinions filed with the Supervisor of Insurance, the draft actuarial schedule for the year  
25 ending September 30, 2004, and the declarations of DBIC's third party administrator and CPA, all  
26 demonstrate that DBIC is not operating as a Ponzi scheme, but rather is a legitimate insurance  
27 company that has been and continues to be capable of meeting its obligations to its insureds.

28

1 **B. DBIC'S FUNDS WERE NOT "LOOTED" BY PAYMENTS TO THE JACQUOT**  
2 **TRUST ACCOUNT**

3 Although it failed to produce any evidence that DBIC's assets are insufficient to satisfy the  
4 claims of its insureds, the Government nevertheless alleges that an injunction is necessary to  
5 prevent the "looting" of DBIC's accounts. Gov't Brief at 17. The Government's allegation of  
6 "looting" is based on evidence of wire transfers from DBIC to David Jacquot's trust account,  
7 France Decl. ¶¶ 25, 27, and to attorney Mike Durney. *Id.* ¶ 76.

8 First, as demonstrated above, the payments made to the Jacquot account were from surplus  
9 funds, as DBIC has sufficient assets to pay all current and future expected claims of its insureds  
10 notwithstanding those payments. Based on this showing alone, the Government's claim that  
11 extraordinary relief is necessary because without it there will be no funds available for  
12 policyholders fails. Second, the declaration and spreadsheet prepared by Steven Farrington, the  
13 CPA who performs accounting services for DBIC,<sup>13</sup> show that the wire transfers to the Jacquot  
14 trust account were for ordinary business expenses.

15 As a Barbados insurance company, DBIC did not have a U.S. bank account for operations,  
16 and therefore made certain payments for U.S. expenses through its lawyer's trust account.  
17 Farrington Decl. ¶ 4. The Farrington declaration and attached spreadsheet account for all of the  
18 transfers to and out of that trust account. See Farrington Decl. ¶¶ 5-6 & Exh. 1. A review of the  
19 expenses paid out of the account demonstrates that there was no "looting", but rather the payment  
20 of ordinary business expenses that DBIC was entitled to make.

21 First, most of the expenditures were for payments with respect to claims from a viatical  
22 surety bond assumed by DBIC, for United States taxes and for attorney and actuarial fees.<sup>14</sup> *Id.*  
23 ¶ 6. In or around 2000, xélan of BVI made an investment decision to act as a surety guaranteeing

24 \_\_\_\_\_  
25 <sup>13</sup> Mr. Farrington met with the receiver and his lawyer and accountants on November 10,  
26 2004, and provided them with an audit binder showing all assets, liabilities and expenses of DBIC  
27 for 2004, as well as a set of spreadsheets tracing all funds paid to Jacquot and others. Farrington  
28 Decl. ¶ 9.

<sup>14</sup> DBIC made several payments to Doctors Insurance Services, Inc. ("DIS"), an entity  
owned by Les Buck, and one payment directly to Mr. Buck to pay back a \$250,000 loan provided  
during the establishment of DBIC's predecessor. *Id.* ¶ 6e.j. Both the return of capital and payment  
for services rendered by Mr. Buck in the operation of DBIC were proper.

1 viatical insurance contracts. The underlying life insurance policies did not pay off when expected,  
2 and DBIC made payments under its guarantee. So long as DBIC continues to make the premium  
3 payments on the underlying life policies, it will be paid upon the death of the insureds the  
4 approximate amount of \$21.7 million. *Id.* ¶ 6a & Exh. 2 at 9. In addition to the payments of  
5 \$20,945,067 on the viatical guarantees, the aggregate sum of \$6,913,967 was paid from the  
6 Jacquot account to the United States Treasury for excise taxes, an additional \$1,701,718 was paid  
7 to SEI for federal withholding taxes, and the aggregate sum of \$1,085,162 was paid for attorneys  
8 fees. *Id.* ¶ 6 & Exh 1.

9 A corporation is entitled – indeed required – to allocate funds for ordinary business  
10 expenses, and this is what DBIC has done here. *See, e.g., Lee v. Interinsurance Exchange of the*  
11 *Automobile Club of Southern California*, 50 Cal.App.4th 694, 710 (Cal. Ct. App. 1997) (affirming  
12 dismissal of policyholders' suit to require disposal of surplus funds in a particular way and stating  
13 that "[w]e can hardly disagree with the proposition that decisions as to strategies for managing the  
14 surplus funds of an insurer are quintessential exercises of business judgment.").

15 Moreover, DBIC may pay attorneys, including attorneys for other parties, where it  
16 determines that such representation is helpful to defending its very business from assault by the  
17 IRS. Similarly, to preserve its business, and maintain sound customer relations, DBIC may pay  
18 for counsel to represent its insureds who are under audit because they have bought insurance from  
19 DBIC. An insurance company enjoys considerable latitude in deciding how surplus funds are  
20 spent, as that decision is protected by the business judgment rule.<sup>15</sup> *Id.* That latitude extends to a  
21 corporation's decision about whether paying a third party's attorneys' fees is in the best interest of  
22 the corporation. *See Beehan v. Lido Isle Community Assn.*, 70 Cal.App.3d 858, 865-67 (Cal. Ct.  
23 App. 1977) (refusing to overturn homeowners' association's decision not to pay attorney fees  
24 incurred by member in enforcing CC & R's, because decision was protected by the business  
25 judgment rule).

26  
27 <sup>15</sup> The funds deposited in the Jacquot trust account were surplus funds, as the actuaries  
28 had opined that for 2003, more than \$47 million would remain after the payment of all current and  
expected claims. *Gaines Decl.* ¶ 13. The expected actuarial calculation for 2004 confirms a  
surplus of \$11 million, even after all of the payments from the Jacquot account. *Id.* ¶ 14.

1 The Government's argument that it is a fraudulent omission for DBIC not to inform its  
2 policyholders that surplus funds were being used to pay legal fees, or to pay Mr. Buck, is also  
3 without merit. "[T]here can be no fraud [based on nondisclosure] absent a duty to speak,"  
4 *Chiarella v. United States*, 445 U.S. 222, 235 (1980), and the Government provides no authority  
5 for the proposition that an insurance company has a duty to disclose to its policyholders how it  
6 intends to spend surplus funds. *Cf. Langford v. Rite Aid of Alabama, Inc.*, 231 F.3d 1308, 1314  
7 (11th Cir. 2000) (failure of pharmacy to disclose pricing structure of prescription drugs to  
8 customers not a fraudulent omission under 18 U.S.C. §§ 1341, 1343, because pharmacy had no  
9 affirmative duty, implied or otherwise, to disclose that information). Moreover, it is unrealistic to  
10 suggest, as apparently Mr. France does, that doctors would be surprised to find payments to  
11 Mr. Buck for services rendered by him to DBIC, or payments to lawyers who were trying to  
12 defend the DBIC disability insurance program from IRS attack.

#### 13 IV.

#### 14 **DBIC DID NOT MISREPRESENT THE NATURE OF ITS PRODUCT**

15 The Government contends that various misrepresentations were made with respect to the  
16 sale of DBIC supplemental disability insurance to the doctors, and in particular, that "Guess,  
17 Buck, Jacquot, Roberts and others" engaged in a scheme to cause doctors to put millions into  
18 DBIC, and that DBIC did not operate as represented. Gov't Brief at 17.

19 The principal false representation alleged is that premiums paid by doctors for insurance  
20 were tax deductible. The Government, however, offers no support for its claim that those who  
21 made the statements believed they were false when made. To the contrary, the evidence indicates  
22 that all of the defendants believed that the supplemental disability insurance offered by DBIC was  
23 in fact insurance and, like other disability insurance, its premiums were deductible. That belief  
24 was supported by DBIC's operation as a real insurance company, and the advice of lawyers and  
25 actuaries. A.M. Best agreed that DBIC was a real insurance company, selling real disability  
26 insurance. That the Government challenges the disability insurance as insurance under the Internal  
27 Revenue Code does not make it a false statement for the doctors to be told that disability insurance  
28 is being offered.

1 The remaining alleged misrepresentation relate to the alleged failure of Dr. Guess to  
2 disclose his receipt of commissions.<sup>16</sup> While Dr. Guess did not receive commissions from DBIC,  
3 he did receive investment advisory fees through his ownership of XIS. Gaines Decl. ¶ 27. The  
4 Government has made no showing that doctors were unaware, or were not informed, that XIS  
5 served as the financial advisor with respect to the funds invested by DBIC. Similarly, since  
6 insurance companies normally have investment advisors, *id.*, there is no showing that it would  
7 have been material to doctors that the service was provided by a xélan entity as opposed to some  
8 other advisor.

9 V.

10 **DBIC HAS NOT DELAYED OR HINDERED THE IRS INVESTIGATION**

11 Mr. France alleges that xélan has attempted to delay and impede the IRS investigation in  
12 several ways and the Government points to those allegations as evidence of a conspiracy to  
13 defraud the United States. Gov't Brief at 17. For the reasons set forth in the Memorandum of  
14 Points and Authorities filed by Donald Guess, Mr. France's claims lack merit, and DBIC joins in  
15 that memorandum.

16 One of the claims made by Mr. France concerning DBIC is that xélan and DBIC induced  
17 or coerced their clients to agree to be represented by DBIC's lawyers by conditioning payment of  
18 their clients' legal fees on use of those lawyers. France Decl. ¶ 79. DBIC's actions in providing  
19 counsel for doctors under audit were not improper and did not constitute coercion. There are  
20 currently over one hundred IRS audits of DBIC clients in process, and all involve the same  
21 overlapping issue of whether premiums paid for DBIC's insurance are tax-deductible. DBIC made  
22 the business decision to make available at no cost to the doctors one law firm to handle all of these  
23 identical challenges to the deductibility of insurance premiums. Doctors under audit were free to  
24 hire counsel of their own choosing, at their own cost. DBIC's decision to make a single firm

25 \_\_\_\_\_  
26 <sup>16</sup> The allegations with respect to the failure to disclose the payment of legal fees of  
27 others, and the failure to disclose payments to Mr. Buck, have been previously addressed. With  
28 respect to the Government's allegations of misrepresentations concerning segregated accounts,  
investment decisions and control over funds, DBIC incorporates herein the memorandum of points  
and authorities filed by Dr. Guess. DBIC is not charged with making any of these alleged  
misrepresentations.

1 available was properly made, as it provided an efficient and cost effective way for DBIC to back  
2 up its insureds in what it believed to be an unwarranted government challenge to the disability  
3 program.

4 Mr. France also asserts that xélan deliberately attempted to thwart IRS investigations by  
5 arranging for its lawyers to refuse to turn relevant documents over to the IRS. France Decl. ¶ 69.  
6 To the extent that this allegation is made with respect to DBIC, it is meritless. The IRS has never  
7 directly asked for any document from DBIC. When lawyers representing xélan asked DBIC to  
8 turn over actuarial reports and other documents requested by the IRS, DBIC did so, through  
9 xélan's lawyers. Gaines Decl. ¶ 37.

10 VI.

11 **THE EVIDENCE DOES NOT SUPPORT THE ISSUANCE OF A PRELIMINARY**  
12 **INJUNCTION OR OTHER EXTRAORDINARY RELIEF**

13 A. **NEITHER 18 U.S.C. 1345 NOR 26 U.S.C. 7402(a) PROVIDE A PROPER BASIS**  
14 **FOR THE EXTRAORDINARY RELIEF SOUGHT BY THE GOVERNMENT**

15 For the reasons set forth above, the Government has failed to establish the predicate for  
16 injunctive relief under 18 U.S.C. § 1345, *i.e.*, that a mail or wire fraud, or conspiracy to defraud  
17 the United States, has been committed. Moreover, for the reasons set forth in the Memorandum of  
18 Points and Authorities of L. Donald Guess, in which we join, § 1345 injunctive relief is not  
19 appropriate for the present case.

20 With respect to its claims under 26 U.S.C. 7402(a), the Government has failed to  
21 demonstrate that the relief sought is necessary or appropriate for the enforcement of the internal  
22 revenue laws. Although the Government does not allege that DBIC itself failed to pay taxes, it  
23 claims that the wholesale seizure of DBIC's assets is appropriate for the enforcement of the  
24 internal revenue laws because doctors that purchased disability insurance from DBIC **may not**  
25 have assets sufficient with which to pay a deficiency that **may be** assessed, and therefore **may**  
26 need to rely on funds held by DBIC to pay taxes the Government alleges **may be** owed. Without  
27 providing information about a single doctor's alleged tax liability or assets, the Government  
28 contends the court should proactively seize all the assets of DBIC.

1           Such contentions, however, are insufficient to invoke § 7402(a). While courts have  
2 suggested that a court's power under § 7402(a) is broad, **no court has sanctioned an application**  
3 **of that power even approaching what is sought by the Government in this case.** The  
4 Government has failed to cite, and we have been unable to find, a single case in which the assets  
5 of a company have been frozen wholesale on the basis that **some** of the taxpayers with an interest  
6 in those assets **might** owe some **undetermined amount** of taxes that the Government **may not** be  
7 able to collect from the taxpayers' other assets. Instead, courts exercising their power under  
8 § 7402(a) acted in response to concrete and specific allegations. *See, e.g., Brody v. United States,*  
9 *243 F.2d 378 (1st Cir. 1957); United States v. First Nat'l City Bank, 568 F.2d 853, 855-856 (2d*  
10 *Cir. 1977).* In none of these cases did the court grant an injunction seizing the assets of an entire  
11 company based on generalized speculation about a pool of unnamed taxpayers that have an  
12 interest in some of those assets.

13           Despite that over one hundred audits involving DBIC customers are ongoing, the  
14 Government has failed to cite even a single example of its alleged inability to recover on unpaid  
15 tax obligations. The Government's generic and unsupported assertion that some taxpayers with an  
16 interest in DBIC's assets might be unable to satisfy their possible tax obligations without relying  
17 on the funds held by DBIC does not demonstrate that the seizure of all DBIC's assets is either  
18 necessary or appropriate to the enforcement of the internal revenue laws.

19 **B.    THE GOVERNMENT IS NOT LIKELY TO SUCCEED ON THE MERITS**

20           If the Court were to find that the statutes relied on by the Government do provide a basis  
21 for relief under the circumstances of this case, then to obtain the extraordinary relief it seeks, the  
22 Government must demonstrate "either (1) a combination of probable success on the merits and the  
23 possibility of irreparable harm, or (2) the existence of serious questions going to the merits, the  
24 balance of hardships tipping sharply in its favor, and at least a fair chance of success on the  
25 merits." *Owner Operator Independent Drivers' Association, Inc. v. Swift Transportation Co.,*  
26 *Inc., 367 F.3d 1108, 1110 (9th Cir. 2004).*

27           Injunctive relief under 18 U.S.C. § 1345 requires the Government to show that it is likely  
28 to succeed on the merits of its claims that DBIC violated 18 U.S.C. § 1341 (mail fraud), 18 U.S.C.



1 § 1343 (wire fraud), and/or 18 U.S.C. § 371 (conspiracy to defraud the United States). Proof of  
2 mail and wire fraud requires proof of a scheme to defraud with the specific intent to defraud. *E.*  
3 *g.*, *United States v. Munoz*, 233 F.3d 1117, 1129 (9th Cir. 2000). Proof of a conspiracy to defraud  
4 the United States requires proof of an agreement with one or more persons to obstruct a lawful  
5 function of the Government by deceitful and dishonest means; and an overt act committed by one  
6 of the co-conspirators in furtherance of the agreement's objective. *United States v. Caldwell*, 989  
7 F.2d 1056, 1058 (9th Cir. 1993).

8         The Government cannot prevail on any of these claims, because it cannot show a  
9 fraudulent scheme or specific intent to defraud by DBIC. To prove a specific intent to defraud,  
10 "[t]he Government must prove beyond a reasonable doubt that the defendant knew the  
11 representation was false or was made with reckless indifference to its truth or falsity." *U.S. v.*  
12 *Tarallo*, 380 F.3d 1174, 1185-86 (9th Cir. 2004). The Government contends that the supplemental  
13 disability insurance policies DBIC sells are not tax-deductible, and that DBIC is engaged in an  
14 "unlawful scheme" by selling these policies while representing to insureds that those policies are  
15 tax-deductible insurance. Gov't Brief at 17. As demonstrated above, there is absolutely no  
16 evidence that DBIC's characterization of its insurance policies was ever intentionally or recklessly  
17 misleading, much less that DBIC made any representation.

18         Moreover, contrary to the Government's unsupported allegations, DBIC is a legitimate  
19 insurance company, has operated for years as a legitimate insurance company, is recognized and  
20 regulated by the Barbados Supervisor of Insurance as a viable insurance company in good  
21 standing, and has been rated by A.M Best as an insurance company. The Government has  
22 proffered no evidence that representations by others about DBIC products were made "with an  
23 intent to defraud." That the IRS disagrees with DBIC's analysis of its product is not proof that  
24 representations were made with an improper motive or as part of a conspiracy to defraud anyone.

25         Additionally, as demonstrated above, the Government's contention that DBIC is operating  
26 a Ponzi scheme and that the doctors' premiums are being "looted" wholly lacks merit. That DBIC  
27 maintains more than enough assets to honor all of its obligations to its policyholders alone shows  
28 that it is not a Ponzi scheme. Additionally, DBIC has demonstrated that all of the wire transfers

1 the Government deems suspicious covered reasonable and legitimate business expenses.

2 The Government also cannot show that an injunction, a receiver and repatriation of assets  
3 is "necessary or appropriate for the enforcement of the internal revenue laws" under 26 U.S.C.  
4 § 7402(a). First, the Government has not shown that it is likely to succeed in proving that DBIC's  
5 supplemental disability insurance is not insurance, and therefore is not tax-deductible. The  
6 evaluations of five independent actuaries shows that DBIC's product is insurance and that the  
7 premiums paid reflect the cost of the insurance provided. Second, the evidence that DBIC  
8 operates as a legitimate insurance company, and maintains sufficient reserves to honor its  
9 obligations to its policyholders, shows that the drastic remedy requested by the Government is not  
10 needed to preserve potentially taxable funds.

11 The Government asserts that it need not show irreparable harm since the injunctions sought  
12 are authorized by statute. The Ninth Circuit has made it clear that to avail itself of the statutory  
13 presumption, if one even exists,<sup>17</sup> a strong showing that the Government is likely to succeed is  
14 required. *Miller v. Cal. Pac. Medic. Ctr.*, 19 F.3d 449, 459 (9th Cir. 1994). Where only a  
15 "colorable evidentiary showing of a [statutory] violation [is made], the court must consider the  
16 possibility of irreparable injury." *Id.* (quotation omitted).

17 The Government has not come close to showing that it will likely succeed on the merits,  
18 and has made no showing of irreparable harm. Its request for injunctive relief should be denied.

19 **C. THE BALANCE OF HARDSHIPS WEIGHS IN FAVOR OF NOT ISSUING THE**  
20 **PRELIMINARY INJUNCTION AND OTHER EXTRAORDINARY RELIEF**

21 Even if the Government had demonstrated that it was likely to succeed on the merits,  
22 which it has not, injunctive relief would not be warranted because the balance of hardships does  
23 not weigh in its favor.<sup>18</sup> While the draconian measures the Government wants to impose would  
24 effectively put DBIC out of business and deny the doctors the benefits of the insurance policies  
25 they paid for, those same measures are not needed to preserve the doctors' funds or the taxes the  
26

27 <sup>17</sup> See *United States v. Stephenson*, 313 F. Supp. 2d 1054, 1056 (W.D. Wash. 2004).

28 <sup>18</sup> The Government acknowledges that it must show the balance of hardships tip in its favor, even though, it contends, it does not have to show irreparable harm.

1 Government contends may be owed.

2 **1. Granting the Extraordinary Relief Sought Would Put DBIC Out of Business**  
3 **and Prevent DBIC's Customers from Benefiting from the Insurance Policies**  
4 **For Which they Paid.**

5 "The purpose of a preliminary injunction is merely to preserve the relative positions of the  
6 parties until a trial on the merits can be held." *University of Texas v. Camenisch*, 451 U.S. 390,  
7 395 (1981). This is not what would occur were the Court to grant the requested preliminary  
8 injunction order. Rather, a preliminary injunction freezing DBIC's assets, appointing a receiver  
9 and/or repatriating foreign assets would essentially dissolve DBIC and put it out of business.

10 Without funds with which to pay basic operating expenses, DBIC would be forced to lay  
11 off its staff, and would be unable to meet the regulatory conditions imposed by the Barbados  
12 Supervisor of Insurance necessary to continue as an insurance company. Evans Decl. ¶¶ 3-4.  
13 Without funds to pay its legal fees, as well as the legal fees of those to whom it owes an obligation  
14 of indemnity, DBIC would be unable to defend itself in this action. Without the ability to properly  
15 invest the funds it currently possesses, DBIC's ability to maintain sufficient assets to honor future  
16 disability claims and other obligations would be jeopardized. At present, DBIC is obligated to pay  
17 over \$225,000 per month to insureds as disability benefits. Patton Decl. ¶¶ 25-26. Additionally,  
18 DBIC must continue to make monthly premium payments to preserve its viatical bond subrogation  
19 assets. If it fails to make those payments, DBIC stands to lose over \$21 million. Farrington Decl.  
20 ¶ 6a & Exh. 2 at 9.

21 Entry of the requested injunctive relief would deprive doctors who are disabled, and those  
22 who may later become disabled, from collecting the benefits for which they paid. Similarly, the  
23 issuance of a preliminary injunction would signal to the insureds that their funds are at risk, and  
24 that a court has indicated that the IRS is likely to prevail in the audits. Between that, the resulting  
25 rescission claims that would follow, and the cessation of premium payments, DBIC would be  
26 effectively shut down, without its day in court.

27 The Government has not shown that DBIC defrauded doctors into buying insurance they  
28 did not want, nor has the Government shown that DBIC has ever wrongfully refused to provide an

1 insured with the disability benefits to which that insured is entitled under the disability insurance  
2 contract. Yet the preliminary injunction requested here would essentially work a rescission of  
3 those contracts against the wishes of the doctors in whose interests the Government claims to be  
4 acting. A preliminary injunction would not preserve the status quo in this case, but would rather  
5 put DBIC out of business, and would cause the cancellation of the supplemental disability policies  
6 of over a thousand doctors. The Government cannot fairly claim that the injunction is in the  
7 interests of the doctors it claims to want to protect. If the supplemental disability insurance  
8 offered by DBIC is found at trial to be insurance, there will be no insurance company to  
9 administer the insurance, and no policies left for the benefit of the doctors who purchased  
10 insurance.<sup>19</sup>

11 **2. The Measures the Government Requests Are Not Needed to Preserve the**  
12 **Taxes the Government Alleges are Owed**

13 While the proposed injunction would put a permanent end to DBIC's legitimate activities  
14 and the ability of DBIC's clients to receive disability insurance before a full adjudication on the  
15 merits, the Government has failed to show that it would not be able to collect all of the taxes  
16 allegedly owed if no injunction is granted.

17 First, the Government has made no showing of the amount of taxes that would be due if it  
18 prevailed in its audits of all of the doctors who purchased insurance from DBIC. The  
19 Government's "guesstimate" is nothing more than rank speculation.<sup>20</sup> Based on a calculation of  
20 **actual premiums paid** by doctors over the three years in question, John Patton has prepared an  
21 estimate of what the taxes due would be if the Government were to prevail on all of its theories.  
22 Patton Decl. ¶ 21. Mr. Patton's analysis yields a figure of \$114,612,827. Therefore, even were

23  
24 <sup>19</sup> While DBIC strongly believes that the Government's request for injunctive relief  
25 should be denied, if the Court decides to grant such relief, DBIC requests that the Court's order  
26 permits DBIC to make the following payments: (1) ordinary and necessary business expenses for  
27 operations; (2) claims for insureds currently on disability; (3) legal fees of attorneys for DBIC in  
28 connection with this investigation and proceeding; (4) legal fees of attorneys for parties to whom  
DBIC owes a duty of indemnity, including current and past directors; and (4) payments necessary  
in connection with the viatical surety obligation, and to pay premiums on assumed policies.

<sup>20</sup> Even the Government's speculative figures would be dramatically reduced if the  
Government prevails only under its second theory of additional tax owing (*i.e.*, that only a portion  
of the premiums are deductible).

1 the Court to accept all of the Government's arguments, any injunctive relief issued under  
2 26 U.S.C. 7402(a) should be limited to that amount.

3         Secondly, the IRS has made no showing that the doctors would not be able to pay any  
4 additional tax due from sources other than DBIC. Thus, the doctors may have more than  
5 sufficient assets in bank accounts, securities, or other investments with which to pay any  
6 deficiency. The IRS has made no attempt to show that no such funds exist, and cannot credibly  
7 claim hardship or irreparable harm without first making that showing.

8         Finally, the evidence submitted with this Opposition demonstrates that DBIC is a  
9 legitimate, financially stable insurance company that has more than sufficient reserves with which  
10 to pay all current and future claims of its insureds. Regardless of whether DBIC's product is  
11 ultimately deemed "insurance," it has maintained sufficient assets to provide the payouts promised  
12 to its customers. The Government has failed to show that those funds would not be available to  
13 satisfy any legitimate claims it may have once the audits are concluded, assessments are made and  
14 a final adjudication of any additional taxes due and owing is rendered.

15         While DBIC would be forever and irreparably harmed by the issuance of a preliminary  
16 injunction or other extraordinary relief, notwithstanding that it is likely to prevail in the ultimate  
17 resolution of the tax issue at hand, the Government has failed to show that it could not satisfy any  
18 deficiencies if it prevailed out of the doctors' bank accounts, securities holdings or other available  
19 funds, or out of the reserves held by DBIC for current and future claims of its insureds.  
20 Accordingly, the balance of hardships tilts decidedly in favor of not granting the injunctive relief  
21 sought.

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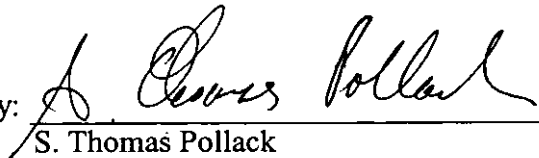
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CONCLUSION

For the foregoing reasons, DBIC respectfully requests that the Court deny the Government's motion for a preliminary injunction, appointment of a receiver and repatriation of foreign assets.

Dated: November 19, 2004

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