

United States District Court  
For the Northern District of California

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E-FILED on 3/27/09

IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF CALIFORNIA  
SAN JOSE DIVISION

B. DAVID MEHMET,  
Plaintiff,  
v.  
PAYPAL, INC.,  
Defendant.

No. C-08-01961 RMW  
  
ORDER GRANTING IN PART AND  
DENYING IN PART DEFENDANT'S  
MOTION TO DISMISS PURSUANT TO  
FRCP 12(b)(6) AND 9(b)  
  
[Re Docket Nos. 28 and 46]

On September 26, 2008, the court heard oral argument on defendant's motion to dismiss the first, second, third, fourth, seventh, eighth, tenth and eleventh causes of action and took the motion under submission. Having considered the papers submitted by the parties and the arguments at hearing, for good cause appearing, defendant's motion is granted in part and denied in part.

**I. BACKGROUND**

**A. Factual Background**

PayPal operates an online money transfer service at its website, www.paypal.com. Am. Compl. ¶ 5 ("AC"). On or about July 25, 2007, Mr. Mehmet used PayPal's service to transfer \$750 to Eric Anderson to pay for a "film treatment." AC ¶¶ 6-7, 36. PayPal's fraud detection software



- 1 (2) fraudulent concealment, based on representations in PayPal's User Agreement that it  
2 would not interfere with Mr. Mehmet's online money transfers without good cause  
3 and concealment of the possibility and risk of "false positives";
- 4 (3) fraudulent inducement, based on the same conduct;
- 5 (4) negligent misrepresentation, based on the same conduct;
- 6 (5) defamation, based on the email sent by PayPal to Eric Anderson allegedly accusing  
7 Mr. Mehmet of fraud;
- 8 (6) defamation per se, based on the same conduct;
- 9 (7) conversion, based on PayPal's alleged initial refusal to transfer Mr. Mehmet's funds to  
10 Eric Anderson or return them to Mr. Mehmet, and PayPal's conduct in refusing to pay  
11 Mr. Mehmet for interest accrued on the withheld funds;
- 12 (8) tortious interference with business relationship, based on PayPal's refusal to transfer  
13 Mr. Mehmet's funds to Eric Anderson after Mr. Mehmet provided PayPal with a copy  
14 of the contract between Mr. Mehmet and Mr. Anderson;
- 15 (9) intentional infliction of emotional distress, based on the alleged emotional distress  
16 Mr. Mehmet suffered as a result of PayPal's conduct;
- 17 (10) unlawful, unfair and fraudulent business practices violating Cal. Bus. & Prof. Code §  
18 17200, based on PayPal's overall conduct and in particular its alleged concealment of  
19 the existence of "false positives"; and
- 20 (11) racketeering, in violation of 18 U.S.C. § 1961 ("RICO"), based on PayPal's alleged  
21 concealment of the existence of "false positives" and its use of electronic  
22 communications to do so, its erroneous characterization of Mr. Mehmet's transaction  
23 as fraudulent and its use of electronic communications to do so, and its failure to pay  
24 interest accrued on Mr. Mehmet's funds while those funds were withheld.

25 **B. Procedural Background**

26 Now before the court is defendant's motion to dismiss the first through fourth, seventh,  
27 eighth, tenth and eleventh causes of action for failure to state a claim upon which relief can be  
28 granted. Defendant has not sought dismissal of the fifth cause of action for defamation, sixth cause

1 of action for defamation per se, or the ninth cause of action for intentional infliction of emotional  
2 distress.

## 3 II. ANALYSIS

### 4 A. Judicial Notice of PayPal's User Agreement

5 As a preliminary matter, PayPal gain asks that this court to again take judicial notice of its  
6 User Agreement. (Memo. in Support at 3 fn. 2.) The court previously took judicial notice of the  
7 User Agreement in determining the previous motion to dismiss and finds that it is appropriate to do  
8 so again.<sup>1</sup>

### 9 B. Motion to Dismiss Fraud-Based Claims

10 PayPal seeks dismissal of the first three causes action for fraudulent misrepresentation,  
11 fraudulent concealment, and fraudulent inducement under Rule 9(b) for failure to plead fraud with  
12 the requisite particularity. PayPal also seeks dismissal of the fourth cause of action for negligent  
13 misrepresentation for the same reasons.

14 Rule 9(b) imposes a heightened standard for pleading claims of fraud. Under Rule 9(b), a  
15 plaintiff must "state with particularity the circumstances constituting the fraud." FRCP 9(b). This  
16 has been construed to require a plaintiff to "state precisely the time, place and nature of the  
17 misleading statements, misrepresentations and specific acts of fraud." Kaplan v. Rose, 49 F.3d  
18 1363, 1370 (9th Cir. 1994), cert. denied, 516 U.S. 810 (1995). The plaintiff must also "set forth an  
19 explanation as to why the statement or omission complained of was false and misleading." In re  
20 GlenFed Sec. Litig., 42 F.3d 1541, 1548 (9th Cir. 1994).

21 Having reviewed the parties submissions and the Amended Complaint, defendant's motion to  
22 dismiss is well-founded.

#### 23 1. "Without Good Cause"

24 First, PayPal argues that the fraud-based claims are deficient because each alleges that  
25 PayPal fraudulently misrepresented in its User Agreement that it "would not interfere" with  
26 plaintiff's fund transfers "without good cause," (AC ¶¶ 114-117, 132-33, 135, 137, 141-142), yet

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27 <sup>1</sup> PayPal's "Supplemental Request for Judicial Notice" [Docket 46] filed in connection with its reply  
28 papers, however, is denied.

1 there is no statement in the User Agreement regarding not interfering with transfers "without good  
2 cause." Plaintiff does not identify any such "without good cause" language in the User Agreement  
3 itself, but asserts that the amended complaint

4 properly pleads fraud against the Defendant with particularity to place it on notice by  
5 establishing facts that prove that the (1) Defendant made a misrepresentation in its  
6 user-agreement to the Plaintiff and other consumers concerning blocking accounts,  
7 withholding funds, converting interest payments, charging reversal and charge back  
8 fees upon good cause while concealing the fact that the above actions could be taken  
9 even when there existed NO good cause; but rather a false positive, which is a  
10 mistake caused by the Defendant's anti-fraud detection software....

11 Opp. at 15 (emphasis in original).

12 Plaintiff thus admits that his fraud-based claims are based on the User Agreement but has  
13 failed to identify any specific statement that actually appears in the User Agreement as the basis for  
14 the fraud claims. Accordingly, plaintiff has failed to plead fraud with the particularity required by  
15 Rule 9(b), and the first, second and third causes of action are dismissed with leave to amend. For  
16 the same reason, the fourth cause of action for negligent misrepresentation is also dismissed with  
17 leave to amend.

18 **2. Failure to Disclose "False Positives"**

19 Each of plaintiff's fraud-based claims is also based on PayPal's alleged concealment of facts  
20 concerning "false positives," absent the concealment of which, plaintiff alleges, he would not have  
21 entered into the agreement with PayPal. (AC ¶¶126, 134, 143, 148). Once again, the allegations  
22 relating to the alleged failure to disclose the "false positives" have not been pleaded with the  
23 particularity required by Rule 9(b). The first, second, third and fourth causes of action are dismissed  
24 with leave to amend.

25 **C. Dismissal for Failure to Plead Damages: First, Second, Third, Fourth and  
26 Eighth Eleventh Causes of Action**

27 PayPal also moves to dismiss the first through fourth and eighth causes of action on the  
28 ground that plaintiff has failed to plead cognizable damages, an essential element of each tort. At  
the heart of PayPal's argument is its contention that the limitation of liability provision in Section  
14.7 of the User Agreement prevents plaintiff from recovering consequential damages, such as for  
lost profits and interference with business relations. Section 14.7 provides as follows:

1       **Limitations of Liability.** IN NO EVENT SHALL WE, OUR PARENT,  
2       EMPLOYEES OR OUR SUPPLIERS BE LIABLE FOR LOST PROFITS OR ANY  
3       SPECIAL, INCIDENTAL OR CONSEQUENTIAL DAMAGES ARISING OUT OF  
4       OR IN CONNECTION WITH OUR WEB SITE, OUR SERVICE, OR THIS  
5       AGREEMENT (HOWEVER ARISING, INCLUDING NEGLIGENCE). Some states  
6       do not allow the exclusion or limitation of incidental or consequential damages so the  
7       above limitation or exclusion may not apply to you. OUR LIABILITY, AND THE  
8       LIABILITY OF OUR PARENT, EMPLOYEES AND SUPPLIERS, TO YOU OR  
9       ANY THIRD PARTIES IN ANY CIRCUMSTANCE IS LIMITED TO THE  
10       ACTUAL AMOUNT OF DIRECT DAMAGES.

11       User Agreement ¶14.7 (formatting in original). In making its argument, PayPal places heavy  
12       reliance on the court's August 12, 2008 order denying PayPal's motion to dismiss for lack of  
13       jurisdiction. In seeking dismissal of the first cause of action, for example, PayPal asserts that the  
14       "Court has already determined [that] Plaintiff may not recover any alleged consequential damages or  
15       lost profits, as the limitation of liability contained [in] PayPal's User Agreement 'preclude[s]  
16       recovery of any lost profits or opportunities arising from Mr. Mehmet's use of PayPal's services."  
17       Memo. at 5. PayPal reiterates this same argument in seeking dismissal of the second, third, fourth  
18       and eighth causes of action. Memo at 6, 7 and 8.

19       In doing so, however, PayPal places too much reliance on language it excerpted from the  
20       August 12, 2008 order and overstates the import of such language. The context of the order was  
21       defendant's motion to dismiss for lack of subject matter jurisdiction, and in relevant part, the order  
22       stated that Section 14.7 "appears to preclude recovery of any lost profits or opportunities arising  
23       from Mr. Mehmet's use of PayPal's services" and that such damages could not form the basis for  
24       establishing diversity jurisdiction. Order at 5-6 (emphasis added).<sup>2</sup> That portion of the order was  
25       essentially dicta, however, because the court denied the motion to dismiss after finding that the  
26       defamation claims were sufficient to establish diversity jurisdiction. It was not the court's intent to

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27       <sup>2</sup> The order went on to state that "[i]t thus appears to a legal certainty that Mr. Mehmet cannot  
28       recover from PayPal for these alleged lost opportunities...." August 12, 2008 Order at 6. The "legal  
certainty" language of the order was derived from the Ninth Circuit decision in Christensen v.  
Northwest Airlines, 633 F.2d 529 (9th Cir. 1980), cited by PayPal, which held that the conceivable  
damages in that case (unliquidated tort claim for rude and discourteous conduct by defendant's  
employee) could not "to a legal certainty" meet the threshold for sustaining diversity jurisdiction.  
The language was not intended to be a final determination on the legal effect of the limitation of  
liabilities clause in the User Agreement.

1 finally determine as a matter of law, or as law of the case, that the limitation of liability clause in the  
2 User Agreement precluded consequential damages or tort liability.

3 Limitations of liability clauses generally are enforceable, but there are circumstances in  
4 which a liability limitations clause is not enforceable, such as when the party relying on the clause  
5 acted in bad faith or engaged in fraud, as noted in two of the cases cited by plaintiff. See Opp. at 28,  
6 citing Valve Corp. v. Sierra Entertainment Inc., 431 F. Supp.2d 1091, 1101 (W.D. Wash. 2004) and  
7 Colonial Life Ins. Co. of Amer. v. Elec. Data Sys. Corp., 817 F. Supp. 235, 242-43 (D.N.H. 1993).  
8 Other case law, cited by those cases, is in accord. See RRX Indus. v. Lab-Con, Inc., 772 F.2d 543,  
9 547 (9th Cir. 1985); S.M. Wilson & Co. v. Smith Int'l, 587 F.2d 1363 (9th Cir. 1978). PayPal did  
10 not address these authorities in its reply, but instead relied primarily on the court's August 12, 2008  
11 order.

12 At this stage of the proceedings, and based on the present state of the briefing, the court is  
13 not prepared to rule as a matter of law that the limitation of liability provision precludes plaintiff  
14 from pleading the various tort claims. The effect of the limitation of liability clause may very well  
15 preclude plaintiff from recovering consequential damages, and may very well bar his claim for  
16 tortious interference with business relations, but that issue has not been addressed by the parties in a  
17 manner sufficient to enable the court to issue such a ruling at this time and is more properly reserved  
18 for resolution at a later stage of the proceedings. Accordingly, defendant's motion, on this basis, is  
19 denied without prejudice.

20 **D. Motion to Dismiss Seventh Cause of Action for Conversion**

21 Plaintiff's seventh cause of action is for conversion, alleging that PayPal "wrongly gain[ed]  
22 possession of the Plaintiff's funds," "wrongly refused to return" such funds upon request, and  
23 "wrongly convert[ed] Plaintiff's interest payments to its own use." AC ¶175-76. Defendant moves to  
24 dismiss the claim for conversion, arguing that the Amended Complaint concedes that PayPal has  
25 returned to plaintiff the funds that had been suspended (AC ¶24) and that plaintiff had no right to  
26 interest on the funds because he waived the right to interest in entering the User Agreement. Section  
27 5.2 of the User Agreement states:





1 The court concurs. The Section 17200 claim is based on the same false representations that  
2 underlie the fraud claims that the court has already determined to have not been pleaded with  
3 sufficient particularity. So too the RICO claim sounds in fraud (see AC ¶204 (concealing false  
4 positives) and ¶¶ 209 et seq. ("fraudulent scheme"), and it too, must be pleaded with particularity.  
5 Vess v. Ceiba-Geigy Corp., 317 F.3d 1097 (9th Cir. 2003).


6 Accordingly, the tenth and eleventh causes of action are dismissed with leave to amend.

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**III. ORDER**

For the foregoing reasons, the court grants defendant's motion to dismiss in part and denies it  
in part. The first, second, third, fourth, seventh, tenth and eleventh causes of action are DISMISSED  
WITH LEAVE TO AMEND. The motion to dismiss the eighth cause of action is DENIED  
WITHOUT PREJUDICE. Plaintiff shall have twenty days in which to file an amended complaint.

DATED: 3/26/09

  
RONALD M. WHYTE  
United States District Judge

1 **Notice of this document has been electronically sent to:**

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8 Counsel are responsible for distributing copies of this document to co-counsel that have not  
9 registered for e-filing under the court's CM/ECF program.

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11 **Dated:** 3/27/09 \_\_\_\_\_

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**Chambers of Judge Whyte**

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