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UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In Re: Mortgages, Ltd., Debtor.	Case No. **2:08-bk-07465-RJH** Chapter 11
VICTIMS RECOVERY, L.L.C., an Arizona limited liability company, Plaintiff, vs. GREENBERG TRAURIG LLP, a New York limited liability partnership; *et al.*, Defendants.	Adversary Proc. No. **2:10-ap-01214-RJH** **PLAINTIFF'S RESPONSE TO MOTION TO STAY PROCEEDINGS PENDING COMPLIANCE WITH DISPUTE-RESOLUTION PROCEDURES**

How can one group of Defendants, Mayer Hoffman McCann, P.C., CBIZ, Inc., CBIZ MHM, LLC, Charles McLane and his wife, and Joel Kramer and his wife (collectively, "MHM"), who are non-debtors in this action, unilaterally invoke the contractual alternative dispute resolution ("ADR") provisions contained in the pre-bankruptcy agreements between the Debtor Mortgages Ltd. ("MLtd") and its investors who assigned their claims to Plaintiff Victims Recovery, L.L.C. ("VR") in order to stay the litigation of VR's claims against those Defendants?

The plain answer is that the MHM Defendants cannot because none of them were ever parties to, and none were expressly or impliedly intended to benefit from, MLtd's contractual ADR provisions with the investors

who assigned their claims to VR ("the VR Investors). As much as VR would certainly be amenable to, and, in fact, already have discussed with some Defendants, the mediation of VR's claims, nevertheless, the ADR provisions in the agreements between MLtd and the VR Investors do not give MHM the right to stay this lawsuit or to enforce those provisions.

Because of this, plus the fact that if the MHM Defendants ever had any rights under MLtd's contractual ADR provisions, they have waived or are estopped from asserting any such rights, this Court should deny MHM's motion to stay for the reasons and authority discussed in the following Memorandum of Points and Authorities.

MEMORANDUM OF POINTS AND AUTHORITIES

I. BACKGROUND

VR's Complaint alleges various independent claims, including professional negligence against MHM and Defendants Greenberg Traurig LLP and two of its lawyers, Robert Kant and Jeffrey Verbin (collectively, "GT"), and independent claims of common law and statutory fraud against all Defendants, as well as claims of aiding and abetting MLtd's and its owner Scott Cole's breaches of contract, MLtd's bad faith and breaches of fiduciary duty, and civil conspiracy against all Defendants. By bringing these claims, VR seeks to recover damages from all of these Defendants for the losses the VR Investors sustained from their investments in MLtd's Revolving Opportunity ("RevOp") Loan Program, which damages were proximately caused by the Defendants' own, independent negligence and other misconduct, separate and apart from any of MLtd's otherwise actionable misconduct.

As the MHM Defendants state in their motion, VR acknowledges that each of the VR Investors executed either an "Existing Investor Account Agreement" or a "New Investor Subscription Agreement" (collectively, "Account Agreements") that contained specific dispute resolution provisions. However, MHM fails to note that the applicability of such provisions, as unambiguously stated in §§ 8(d)(ii-v) of the New Investor Subscription Agreement, is limited to the "parties" to the Account Agreements. These sections describe exactly who the ADR pro-

visions apply to by listing the obligations of "the ***parties***" (*i.e.*, the parties to "this Agreement, the Offering, the Loans, the Agency Agreement, and any other documents," as opposed to the parties to this lawsuit, which is a critical distinction) to resolve their disputes by the specified ADR procedures. These sections also prescribe certain time limits for those parties to invoke such ADR procedures.

Specifically, §§ 8(d)(ii-iv) provide:

> (ii) In the event of any such controversy or claim, ***the parties*** shall use their best efforts to settle the controversy or claim. To this effect, they shall consult and negotiate with each other in good faith and, recognizing their mutual interests, attempt to reach a just and equitable solution satisfactory ***to both parties***. If they do not reach such solution **within a period of 60 days**, then, upon notice ***by either party*** to the other, all such controversies or claims shall submitted to mediation administered by the American Arbitration Association under its Commercial Mediation Procedures.
>
> (iii) In the event that mediation does not result in a resolution, ***any party*** that still wishes to pursue a controversy or claim shall first notify ***the other party*** in writing within 60 days after the mediation. Upon receipt of such notice, ***the receiving party*** shall elect, in its sole and absolute discretion, to compel the dispute either to court for litigation pursuant to this section or to arbitration pursuant to this section. ***The receiving party*** shall notify ***the other party*** of the election within 10 days after receipt of the notice.
>
> (iv) In the event that the dispute is compelled to arbitration, ***the parties*** agree to submit the unresolved controversies or claims to arbitration administered by the American Arbitration Association …. Within 15 days after the commencement of arbitration, ***each party*** shall select one person to act as arbitrator and the two selected shall select a third arbitrator within ten days of their appointment ….

(Emphasis added).

Moreover, § 8(b) provides: "This Agreement shall be binding upon and inure to ***the benefit of the parties hereto*** and the respective heirs, personal representatives, successors, and assigns of the parties hereto …." (Emphasis added). In addition, § 8(c) provides: "This Agreement contains ***the entire understanding between the parties hereto with respect to the subject matter hereof***, and supersedes all prior and contemporaneous agreements and understandings, inducements, or conditions, ***express or implied***, oral or written, except as herein contained." (Emphasis added).

The only entities identified in the Account Agreements as the "***parties***" or "***parties hereto***" and signatories are (1) MLtd, as the issuer of its loan programs, including its RevOp Loan Program, (2) MLtd's wholly-owned brokerage company, Mortgages Ltd. Securities, L.L.C. ("MLS"), as the dealer-broker for MLtd's loan programs, and (3) the individual investor named in each agreement, including each VR Investor, as the purchaser of MLtd's RevOp Loan Program. The only other person named in the Account Agreements is Scott Coles, who at the time was identified and listed as MLtd's Chairman and CEO and MLS's managing member. As the MHM Defendants admit, it is indisputable, that neither they nor any of the other Defendants were expressly or impliedly identified or named as parties to, or as third-party beneficiaries of, any of those Account Agreements.

For this reason, MHM is correct in stating that VR did not follow any of the ADR procedures spelled out in the Account Agreements before filing this lawsuit against MHM or any of the other Defendants. Nevertheless, during the past few weeks, VR's counsel has engaged in discussions with MHM's counsel and counsel for Defendants Michael Denning and his wife, all of whom have expressed their interest in participating in the mediation of this lawsuit. However, GT's counsel has indicated that the GT Defendants do not want to mediate VR's claims. In fact, only MHM, who had absolutely nothing to do with the preparation, presentation or execution of the Account Agreements, filed a motion to stay VR's lawsuit pending ADR—none of the other Defendants, including GT, who actually drafted the Account Agreements, or Mr. Denning, who, as an MLtd officer, was involved in the use of the Account Agreements, have joined in MHM's motion or have filed their own stay motions.

II. ARGUMENT: WHY A STAY SHOULD NOT BE GRANTED

At the outset of its motion, MHM states that the Court has the "inherent power" to stay lawsuits pending ADR proceedings, citing *George Kessel Int'l, Inc. v. Classic Wholesales, Inc.*, 544 F. Supp. 2d 911 (D. Ariz. 2008). VR does not dispute that. However, MHM fails to note that in the *George Kessel* case our District Court denied the defendant's motion to stay a patent infringement lawsuit pending the USPTO's reexamination of the patent because such a stay was unwarranted.

Nevertheless, the principle that *George Kessel* stands for is that "[i]f there is even a 'fair possibility' that the stay will harm another party, the party seeking a stay must make out a 'clear case of hardship or inequity in being required to go forward." *Id.* at 912-13 (quoting *CMAX, Inc. v. Hall*, 300 F.2d 265, 268 (9th Cir. 1962)). MHM has not made out, and certainly cannot make out, a "clear case of hardship or inequity in being required to go forward" with this lawsuit. The fact that none of the other Defendants have joined in MHM's motion or have filed their own stay motions is strong evidence of the lack of any such hardship, particularly since the other Defendants have an even closer nexus to the Account Agreements than MHM.

In this regard, *George Kessel* adds that another factor that courts consider in deciding whether to stay litigation is "whether a stay would unduly prejudice or create a clear tactical disadvantage to the nonmoving party …." *Id.* at 913. Here, a stay would certainly unduly prejudice or create a clear tactical disadvantage to VR unless all the Defendants were required or agreed to participate in the ADR procedures. Otherwise, some of VR's claims would end up being mediated/arbitrated and other claims litigated, which would result in substantial increases in costs to VR and substantial delays in arriving at a final resolution of all of its claims, particularly if it were later determined that the arbitrated claims were not subject to arbitration after all, which would mean that VR would have to start all over to litigate those claims separately from its claims against the other Defendants.

Aside from these problems, the MHM Defendants argue that they are entitled to enforce the ADR provisions in the Account Agreements because those provisions apply to any dispute relating to or arising out of the private offering memoranda ("POM"), which included their audit reports of MLtd's financial operations and condition. However, the application of the ADR provisions in the Account Agreements involves more than just that. Based on the express limitations of the provisions, the analysis of their application involves not only the question of what types of disputes do they apply to, but also the question of ***who do they apply to***. In other words, two things must be determined: (1) whether the ADR provisions apply to the type of dispute involved in VR's claims; and if so, (2) whether that dispute is a dispute ***between the entities to whom the ADR provisions apply***.

There is little doubt that if this lawsuit were between VR and MLtd and/or MLS, the answer to both questions would be "yes." But, that is not the case. This lawsuit is between VR and Defendants other than MLtd or MLS. So, the answer to the second question in this case is "no," which precludes the application of the contractual ADR provisions to this lawsuit because neither MHM nor any of the other Defendants are identified as parties to the agreements.

The ADR provisions at issue here are similar to the one in *Aerisa, Inc. v. Plasma-Air Int'l*, No. CV 08-227-PHX-NVW, 2008 WL 5210842 (D. Ariz. Dec. 11, 2008), which stated, "'The parties expressly agree to submit any dispute between them' to arbitration." *Id.* at *1. "Therefore, the scope of the arbitration provision does not, on its face, extend to any dispute between Aerisa and the other, ***non-signatory Defendants***.'" *Id.* (emphasis added); *accord Charles Schwab & Co., Inc. v. Reaves*, No. CV-09-2590-PHX-MHM, 2010 WL 447370, *4 (D. Ariz. Feb. 4, 2010) (holding that nonsignatory third-parties did not qualify as third-party beneficiaries of an account agreement or its arbitration provisions because the agreement did not appear to have been expressly intended to benefit them) (citing *Nahom v. Blue Cross and Blue Shield*, 180 Ariz. 548, 552, 885 P.3d 1113, 1117 (App. 1994)), which explains that a party is a third-party beneficiary only if it "definitely appear[s] that the parties intend[ed] to recognize the third party as the primary party in interest" of the provision")).

In an attempt to sidestep this obvious defect, MHM tries to equate the named "parties" in the Account Agreements, who are the VR Investors, MLtd and MLS, as being the same as a the "parties" to this lawsuit, or in their words, "the party against whom the claim is made" (*Motion* at 3), which in this case is MHM. But, again, the fact is that MHM is not a "party" to the Account Agreements and as *Aerisa* holds, MLtd's contractual ADR provisions simply do not provide for such an unwarranted expansion of the term "parties." The bottom line is that the ADR provisions in the Account Agreements apply only to the named parties to those agreements. *End of story!*

Contrary to MHM's assertion on page four of the motion, VR is not trying to "discard" the ADR provisions in the Account Agreements. VR is simply saying that those provisions do

not apply to its claims against MHM or any of the other Defendants because neither MHM nor any of the other Defendants was a party to those agreements. Also contrary to MHM's misplaced reliance on, and quotation out of context from *Noodles Dev., LP v. Latham Noodles, LLC*, No. CV 09-1094-PHX-NVW, 2009 WL 2710137 (D. Ariz. Aug. 26, 2009), controlling case law in the Ninth Circuit clearly demonstrates that MHM, as a non-party to the Account Agreements, cannot enforce the ADR provisions in the agreements because VR's dispute with MHM and the other Defendants "is simply not within the scope of the arbitration agreement, even if it is related in some attenuated way to [the dispute] subject to the arbitration provision." *Mundi v. Union Sec. Life Ins. Co.*, 555 F.3d 1042, 1045 (9th Cir. 2009) (affirming district court's denial of non-party's motion to compel arbitration).

The court's explanation in *Mundi* is instructive because the ADR provision in question there was almost identical to the one at issue here:

> The arbitration provision here defines a dispute as a disagreement between [the bank] and the borrower that "relates in any way to accounts, loans, services or agreements subject to this Arbitration provision." [Plaintiff's] dispute with [a nonsignatory third-party] is not a disagreement between [the bank] and [the borrower]. Although there may be an attenuated relation between [the bank's loan documents] and the dispute between [the nonsignatory] and [plaintiff], … this relation is irrelevant. The arbitration agreement is premised on a disagreement between [the bank] and the borrower. In the absence of such a disagreement, the arbitration provision does not apply. Thus, ***any disagreement between the borrower and a third party***, such as [the nonsignatory], ***is simply not within the scope of the arbitration agreement, even if it is related in some attenuated way to "accounts, loans, services or agreements" subject to the arbitration provision***. … ***The face of the contract accordingly indicates that this dispute is not within the scope of the arbitration provision.***

Id. (emphasis added) (internal quotation marks and citation omitted).

Likewise, even though as MHM argues, VR's claims may be related in some attenuated way to the "[Account] Agreement[s], the Offering, the Loans, the Agency Agreement, and any other documents relating to the Loans," they are not subject to the ADR provisions contained in § 8(d) of the Account Agreements. To the same effect is *Hawkins v. KPMG LLP*, 423 F. Supp. 2d 1038 (N.D. Cal. 2006), where the court refused to allow a nonsignatory

defendant (like MHM) the benefit of an arbitration agreement on the grounds that the plaintiff signatory (like the VR Investors) was not suing the other party to the agreement. As the court concluded, "no claims against [the other signatory] are contemplated, or even possible. In sum, defendants make no plausible argument as to why they should be entitled to assert the arbitration clause." *Id.* at 1052. It is also interesting to note that *Noodles Dev.* cited *Mundi* as well as *Sokol Holdings, Inc. v. BMB Munai, Inc.*, 542 F.3d 354 (2d Cir. 2008), in support of its decision to compel arbitration, but both *Mundi* and *Sokol Holdings* reached the opposite conclusion by affirming denials of motions to stay pending arbitration.

The Mississippi district court case, *Chew v. KPMG, LLP*, 407 F. Supp. 2d 790, 793-94 (S.D. Miss. 2006), that MHM cites certainly does not change the fact that *Mundi*, *Hawkins* and other Ninth Circuit case law cited herein are controlling. In addition, the holding in *Chew* regarding the application of equitable estoppel to compel arbitration was sharply criticized by a recent California case, *Goldman v. KPMG LLP*, 92 Cal. Rptr. 3d 534, 550 (Cal. App. 2009), which also involved investors' claims against accountants and lawyers. Here, like in *Goldman*, VR's claims are not dependent upon—in fact, they are independent from—and are not inextricably bound up with, MLtd's obligations set forth in the Account Agreements.

Other Ninth Circuit case law clearly supports the conclusion that MHM, as a nonparty to the contractual ADR provisions, is not entitled to the requested stay. For example:

> A contract may bind non-parties such as an intended third party beneficiary, an agent, or an assignee. But ***generally arbitration clauses and contracts do not bind non-parties in the absence of such extraordinary relationships***. The strong public policy in favor of arbitration does not extend to those who are not parties to an arbitration agreement …. The common thread … is the existence of an agency or similar relationship between the nonsignatory and one of the parties to the arbitration agreement. ***In the absence of such a relationship, courts have refused to hold nonsignatories to arbitration agreements***.

Comedy Club, Inc. v. Improv West Assoc., 553 F.3d 1277, 1287 (9th Cir. 2009) (emphasis added) (internal quotation marks and citations omitted); *see also Comer v. Micor, Inc.*, 436 F.3d 1098, 1102 (9th Cir. 2006) (holding that arbitration provisions do not apply to nonsignatories under either equitable estoppel or third-party beneficiary principles).

This conclusion is also supported by Arizona case law, which holds that under the Arizona Uniform Arbitration Act (A.R.S. §§ 12-1501, *et seq*.) a party to an arbitration agreement cannot compel arbitration against a non-party to the agreement. *E.g.*, *Able Distrib. Co. v. James Lampe, Gen. Contr.*, 160 Ariz. 399, 410, 773 P.2d 504, 515) (App. 1989) ("A.R.S. § 12-1501 binds only the parties to the arbitration agreement, and is therefore inapplicable to non-parties").

MHM's reliance on *Hansen v. KPMG, LLP*, No. CV 04-10525-GLT, 2005 WL 6051705 (C.D. Cal. Mar. 29, 2005), is also misplaced and of little or no precedential value because in that unpublished decision rendered in 2005, the district court specifically stated that there was no Ninth Circuit case law on point at that time. However, since then the *Mundi*, *Comedy Club*, *Comer*, *Goldman* and *Hawkins* decisions were handed down, and those published decisions, as well as the others that VR cites, clearly support the denial of MHM's motion.

Finally, two other reasons why MHM is not entitled to a stay to compel compliance with the ADR provisions of the Account Agreements exist.

First, a nonsignatory to an arbitration agreement may enforce the agreement only "***if [it] is bound by the agreement under ordinary contract and agency principles***." *Valdiviezo v. Phelps Dodge Hidalgo Smelter, Inc.*, 995 F. Supp. 1060, 1063 (D. Ariz. 1997). MHM simply cannot argue that it is bound in any way by the Account Agreements between the VR Investors and MLtd/MLS under ordinary contract and agency principles because MHM had absolutely nothing to do with those agreements and had no obligations thereunder.

Second, the MHM Defendants are not entitled to enforce the ADR provisions because they, themselves, did not comply with the mediation time limit provided for in the Account Agreements. Section 8(d)(ii) of the Account Agreements provides that if the parties to a controversy or claims (assuming for the sake of argument that the ADR provisions do apply to VR's claims against MHM) cannot resolve the controversy or claims ***within 60 days***, the controversy or claims shall be submitted to mediation administered by the American Arbitration Association ("AAA") "***upon notice by either party to the other [party]*** …." (Emphasis added).

So, assuming for the sake of argument that the ADR provisions do apply to VR's claims against MHM and that MHM is a "party" to those provisions, MHM had until August 2, 2010, which was 60 days after VR filed its lawsuit on June 1, 2010, to provide notice to VR and to submit this controversy to AAA for mediation.

However, the first notice that the MHM Defendants provided to VR of their desire to enforce the ADR provisions occurred on August 19, 2010, when they filed their present motion to stay, which was preceded by their removal of VR's claims from State court to this Court a month earlier on July 2, 2010. Therefore, the MHM Defendants have waived their right, assuming they ever had such a right, to, or are estopped from, invoking the ADR provisions of the Account Agreements. *See Aerisa, supra* at *1.

III. CONCLUSION

For the above reasons, MHM's motion should be denied. MHM is not entitled to have this Court stay the litigation of VR's claims pending its compliance with any contractual ADR procedures because no such enforceable contractual agreements between VR and MHM exist.

However, in the event the Court disagrees and finds that VR's lawsuit should be stayed pending compliance with the contractual ADR provisions, the Court's order should include reasonable, and as short as practically feasible, specific time limits for the commencement and completion of such ADR procedures, notwithstanding any time limits prescribed in § 8(d) of the Account Agreements, and that, notwithstanding § 8(d)(v), VR would not be precluded from exercising its right to a jury trial, as it has already requested, should the controversy not be resolved by the ADR procedures.

RESPECTFULLY SUBMITTED this 13th day of September, 2010.

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CERTIFICATE OF SERVICE

I hereby certify that on September 13, 2010, I electronically filed the foregoing with the Clerk of the Court using the Court's CM/ECF system and emailed copies of the same to the following:

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