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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 COMBINED RESPONSE TO DEFENDANTS SEPARATE MOTIONS TO DISMISS**

The most obvious question that arises from reading the Motions to Dismiss filed by Defendants Greenberg Traurig LLP, Robert Kant and his wife, and Jeffrey Verbin (collectively, "GT"), Mayer Hoffman McCann, P.C., CBIZ, Inc., CBIZ MHM, LLC, Charles McLane, Joel Kramer and their wives (collectively, "MHM"), and Michael Denning and his wife (collectively, "Denning") is are what Complaint are they are talking about? It certainly cannot be the complaint that Plaintiff Victims Recovery, L.L.C. ("VR") filed in this case because upon careful review of VR's Complaint and consideration of all of its allegations in their entirety, it is difficult to understand how anyone in good faith and with a straight face could argue that the allegations that these Defendants refer to do not put each of these Defendants on fair notice of (a) what they have to defend against and (b) for to draft their respective Answers to the Complaint.

In their motions, these Defendants seem to confuse what is required for pleading

the pre-discovery factual and legal bases for VR's claims with what evidence is required to actually prove those claims at trial. Defendants are certainly free to dispute VR's facts and claims at this stage of this lawsuit by denying them in their Answers, but their disputes of the claims and the facts alleged and inferred from the Complaint certainly do not entitle them to dismissal of VR's claims before any discovery is conducted for the reasons and authority set forth in the following Memorandum of Points and Authorities.

MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

In the factual sections of their motions, GT and MHM extensively recite various paragraphs from VR's Complaint for the facts to be considered on their motions. Those paragraphs describe each Defendant's wrongdoings, but in their arguments they turn around and illogically contend that they have no idea of what wrongful acts they are being accused of or what they have to defend against. To Denning's credit, he makes similar arguments without citing various allegations of the Complaint as the facts to be considered on his motion.

Defendants also filed similar motions in a companion case, *Facciola v. Greenberg Traurig LLP*, No. 2:10-cv-01025-MHM, filed on May 11, 2010, in the District Court for Arizona; and GT and MHM filed similar motions in another companion case, *Ashkenazi v. Greenberg Traurig LLP*, 2:10-ap-01402-RJH, originally filed on July 2, 2010, in Maricopa County Superior Court and removed to this Court (Denning is not a defendant in that case). Because, in addition to other claims, both *Facciola* and *Ashkenazi* involve many of the same claims based on the same facts alleged in VR's Complaint, those plaintiffs' responses to GT's, MHM's and Denning's motions to dismiss are relevant and applicable to the dismissal motions in this case.

Therefore, instead of unduly repeating those arguments, VR has attached the *Facciola* responses to GT's, MHM's and Denning's motions as Exhibits 1-3, and the *Ashkenazi* response to MHM's motion (a response to GT's dismissal motion in *Ashkenazi* has yet to be filed) as Exhibit 4; VR incorporates by reference the arguments contained in those responses and requests the Court take judicial notice of those responses and consider and apply the arguments

and authority that also pertain to GT's, MHM's and Denning's motions to dismiss VR's Complaint. *See Rothman v. Gregor*, 220 F.3d 81, 92 (2d Cir. 2000) (taking judicial notice of complaint filed in another case under Fed. R. Evid. 201(b) in considering motion to dismiss); *accord Botelho v. U.S. Bank, N.A.*, 692 F. Supp. 2d 1174, 1178 (N.D. Cal. 2010) (recognizing Ninth Circuit's traditional interpretation of Fed. R. Evid. 201(b) to allow such consideration). Such Court consideration also would be appropriate because all the parties to this and the *Ashkenazi* actions have agreed that all the dismissal motions in these cases should be heard together at one hearing, which they are in the process of trying to schedule.

In contrast to the separate responses to each motion in *Facciola* and *Ashkenazi*, however, VR has combined its responses to the three separate dismissal motions in this case into this one, combined response for the sake of judicial economy because for the most part these motions contain essentially the same basic authority and arguments (except for GT's and MHM's motions contain additional arguments and authorities concerning their respective professional duties as the lawyers and auditors of the Debtor Mortgages Ltd. ("MLtd"). Moreover, since the attached *Facciola* and *Ashkenazi* responses discuss in great detail and cite extensive case law explaining why the motions to dismiss in those cases (which in substantial parts are identical to the ones under consideration here) should be denied, VR has limited its arguments in this response to those matters not discussed in those responses and to a brief discussion of only the major points of the present motions as they relate to each claim in VR's Complaint.

At the outset, GT and MHM argue that under *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), and *Ashcroft v. Iqbal*, __ U.S. __, 129 S. Ct. 1937 (2009), VR's Complaint is factually insufficient to impose any liability on them. However, a complaint is sufficient if the "'factual content' and reasonable inferences from that content [are] plausibly suggestive of a claim entitling the plaintiff to relief." *Moss v. U.S. Secret Service*, 572 F.3d 962, 969 (9th Cir. 2009). "The plausibility standard is not akin to a 'probability requirement,'" *Ibqal* at 1049), but "[s]pecific facts are not necessary [because the complaint] need only give the defendant fair notice of what the … claim is and the grounds upon which it rests." *Twombly* at 555 (internal quotation marks omitted).

II. ARGUMENT

Far from being a "shotgun" or "puzzle" pleading as Denning asserts, VR's Complaint, when considered in its entirety, sufficiently alleges and infers enough facts to more than plausibly suggest and fairly put Defendants on notice of each of the following claims and the grounds that entitle it to recover damages from GT, MHM and Denning for their misconduct.

A. COUNT ONE (Fraud)

As has become standard practice in fraud cases, Defendants argue that VR has not pleaded its fraud claims with sufficient particularity under Rule 9(b) and that taints all of VR's claims because they all stem from the fraud alleged in its Complaint. However, "Rule 9(b) 'only requires the identification of the circumstances constituting fraud so that the defendant can prepare an adequate answer from the allegations.'" *YF Trust v. JP Morgan Chase Bank, N.A.*, No. CV 07-567-PHX-MHM, 2008 WL 821856, 5 (D. Ariz. Mar. 26, 2008) (denying motion to dismiss) (quoting *Bosse v. Crowell Collier & Macmillan,* 565 F.2d 602, 611 (9th Cir. 1977)). As discussed in the following sections, VR's Complaint sufficiently identifies the circumstances constituting the fraud in this case so that each Defendant can prepare an adequate answer.

In one fashion or another, all of the Defendants assert that the Complaint does not contain or does not sufficiently allege certain factual matters, which are listed below in italics:

- *That Defendants made any representations to, or had any direct communication with, the VR Investors.*

Except for the fact that Denning had at least one more meeting with three of the VR Investors about the UCC-1s pertaining to their investments as alleged in ¶ 69 of the Complaint, VR admits that the Complaint does not allege that any of the Defendants had any direct communication with the VR Investors. However, the lack of any direct communication between the Defendants and the VR Investors does not allow them to escape liability. *See, e.g., Barnes v. Vozack*, 113 Ariz. 269, 274, 550 P.2d 1070, 1075 (1976) (evidence showed that defendants indirectly fraudulently sold stock to investor despite the lack of any direct communication with the plaintiff); *Standard Chartered PLC v. Price Waterhouse*, 190 Ariz. 6, 29, 945 P.2d 317, 340 (App. 1996) (privity not required to maintain auditor negligence claims).

As for what representations the Defendants made to the VR Investors, in ¶¶ 26-28, 33, 48-50, 61, 70, 75-77, 79, 82 and 83 of the Complaint, for example, VR identifies specific documents and representations that the Defendants, both individually and collectively, made to the VR Investors, including the following:

1. the July 12, 2006, private offering memorandum ("POM"), certain investor documents and promotional literature describing MLtd's business that GT prepared or reviewed for MLtd;

2. the 2003-2008 auditors' reports of MLtd's financial statements that MHM prepared, as well as certain MLtd financial statements and quarterly reports that MHM reviewed, approved or prepared; and

3. various written and verbal statements by Denning and other MLtd officers about MLtd's unblemished payment history, the nature of MLtd's Revolving Opportunity ("RevOp") loan investment programs, how MLtd and its wholly-owned brokerage firm Mortgages Ltd. Securities, L.L.C. ("MLS"), were regulated by governmental and industry watchdog agencies and in compliance with securities laws and that GT had "cleared" all of the documents and information provided to MLtd's investors and had "overseen" all of MLtd's sales.

That all the statements contained in the July 2006 POM, which contained the 2004-05 audit reports, were representations that all the Defendants made to the VR Investors is clear because a POM is by its very nature a solicitation to invest. *FDIC v. O'Melveny & Myers*, 969 F.2d 744, 746 (9th Cir. 1992) (explaining that POMs that are "designed to induce outside investors" to buy the issuer's securities). The audited financial statements included in the July 2006 POM were essential parts of the POM and representations that MLtd, including Denning, used to solicit the VR Investors. *See, e.g., In re E.S. Bankest*, No. 04-17602-BKC-AJC, 2010 WL 1417732, *18 (Bank. S.D. Fla. Apr. 6, 2010) (finding substantial evidence that the "audits were the key to [the issuer]'s ability to sell the debenture notes.").

- *What specific documents and statements in those documents that GT and MHM prepared were false, the dates and content of such documents and statements or which of the documents were received and when, and read or used by which specific investors for which of their investments.*

As noted above ¶¶ 26-28, 33, 48-50, 61, 70, 75-77, 79 82 and 83 of the Complaint clearly identify the documents and their dates. In addition, by way of example, ¶¶ 28, 33, 50, 54, 56, 59, 61, 70, 76-79 and 82 of the Complaint further describe the content or substance of the following statements in those documents that constituted false or misleading representations:

1. that MLtd was solvent, able to fund all its loans and never failed to repay investors;

2. that MLtd's RevOp Loan Program investments were legitimate, safe, low risk, "preferred" and "secured";

3. that GT's July POM and its disclosures were true, accurate and complete;

4. that MHM's audit reports and MLtd's financial statements were true, accurate, complete, and conformed to GAAP and GAAS;

5. the sources of MLtd's revenues;

6. that MLtd conducted the requisite due diligence relating to each loan and underlying property before committing to fund it;

7. that MLtd's loans were fully collectible, unimpaired and current;

8. that MLtd was always in compliance with all state and federal securities laws; and

9. that MLtd was not subject to any claims or proceedings that would adversely affect its operations.

In addition, the above paragraphs of the Complaint describe the following omissions, which also made the documents false or misleading:

10. that MLtd booked its real estate assets and mortgages at inflated values;

11. MLtd and MLS's involvement in illegal sales of unregistered securities;

12. MLtd's funding from Radical Bunny, LLC ("RB) through illegal sales of unregistered securities and a large loan from RB on which MLtd had never made any repayment; and

13. MLtd's Ponzi scheme of funding operating capital, debt service and honoring the VR Investors' redemption requests with proceeds received from new investors.

As for which of those documents the VR Investors received and when, which documents they read and used for which investments, the above allegations state or infer or by common sense that all of the VR Investors received all of the documents described above—after all,

the subscription and investor agreements required and indicate that each investor received the July 2006 POM, which in turn, included the auditors' reports, ***before*** each could invest in the RevOp program. The actual dates of when each VR Investor received or read these documents or subsequent auditors' reports and financial statements is immaterial for pleading purposes at this stage of the litigation.

Nevertheless, MLtd's own records will show when each investor received the 2006 POM and the audit reports, and the receipts for the copies of the POM each investor received provide the date each POM was received—all of this can be gleaned from discovery. And, of course, since, as Defendants admit, each of the VR Investors were sophisticated investors, it can be presumed or inferred that they read these documents before investing. *See, e.g., North British & Mercantile Ins. Co. v. San Francisco Sec. Corp.,* 30 Ariz. 599, 602, 249 P. 761, 762 (1926) ("a party is presumed to read and understand the contract he sign"); *In re Nat'l W. Life Ins. Deferred Annuities Litig.,* No. 05-CV-1018-JLS (LSP), 2010 WL 2735732, at *9 (S.D. Cal. July 12, 2010) (inference arises if it provides a "common sense" or "logical explanation" for the behavior of a plaintiff). Again, if that is not the case, that fact and any specific dates that Defendants ask for can be ascertained in discovery. However, the above allegations and reasonable inferences are sufficient to provide Defendants fair notice of the facts they claim are missing. It is unnecessary for VR to "match facts to every element of a legal theory." *Bennett v. Schmidt*, 153 F.3d 516, 518 (7th Cir. 1998); *accord Castillo v. Norton*, 219 F.R.D. 155, 160 (D. Ariz. 2003).

- *That the Defendants knew the 2006 POM or audit reports contained false information or omitted material information, that they knew facts that would contradict the alleged misrepresentations in the POM or audit reports, and that MLtd did not believe the information contained in those documents.*

In ¶¶ 37-40, 48-50, 52, 53, 56-58, 61, 78, 81, 84 and 102 of the Complaint also allege that the GT Defendants, both individually and collectively, knew or should have known that the 2006 POM contained certain false information or omitted certain material information; that the MHM Defendants, both individually and collectively, knew that or should have known that their audit reports and MLtd's financial statements they reviewed and/or helped prepare con-

tained false information or omitted certain material information, and that MLtd's internal controls were deficient; that Denning, as one of the MLtd/MLS corporate Defendants knew the same; and that all of these Defendants knew or should have known that MLtd did not believe the information contained in those documents was true, accurate or complete.

A plaintiff does not have to plead any underlying facts to show that a defendant actually knew that the alleged representations were false. *In re Leslie Fay Cos. Sec. Litig.* 835 F. Supp. 167, 175 (S.D.N.Y. 1993) (denying motion to dismiss securities fraud claims against corporation, its officers and outside auditors). "Rule 9(b) does not require that mental conditions such as intent ***or knowledge*** be averred with particularity …. [Furthermore,] a plaintiff need not plead facts under Rule 9(b) if they are particularly within the opposing party's knowledge." *Id.* at 172 (emphasis added). The District Court's analysis in *Leslie Fay* is particularly apropos to VR's Complaint:

> when tidal waves of accounting fraud are alleged, it may be determined that the accountant's failure to discover his client's fraud raises an inference of scienter on the face of the pleading. … Alleged fraud of this magnitude, coupled with plaintiffs' other allegations, creates an implication of recklessness, on the face of the pleading, which compels us to deny defendant's [dismissal] motion. [A]t this early stage in the litigation, we will not deny plaintiffs the opportunity to conduct discovery …. "[O]nly recklessness need be alleged to establish an accountant's scienter where plaintiffs are third parties whose reliance upon the accountant's audit or opinion letter was foreseeable.

Id. at 175.

Whether or not each individual Defendant knew or is chargeable with knowing that the alleged documents, statements and representations were false, of course, are matters particularly within their knowledge, but the facts alleged in the Complaint certainly are sufficient to show their recklessness, which is sufficient to show their scienter at this stage of the case.

- *That the VR Investors relied on any of Defendants' misrepresentations.*

In addition to ¶ 48, ¶¶ 103, 111 and 113 of the Complaint state that the VR Investors relied on the misrepresentations described above. Moreover, in these circumstances, courts routinely presume reliance. *See Lymburner v. U.S. Fin. Funds, Inc.*, 263 F.R.D. 534, 542 (N.D. Cal. 2010) (applying presumption of reliance in connection with fraud claim based on material

information omitted from loan documents); *In re American Cont'l Corp./Lincoln Sav. & Loan Sec. Litig.*, 140 F.R.D. 425, 433 (D. Ariz. 1992); *Trimble v. Am. Sav. Life Ins. Co*., 152 Ariz. 548, 552-53, 733 P.2d 1131, 1135-36 (App. 1986).

- *That GT and MHM aided and abetted MLtd's fraud, i.e., that they had knowledge of and substantially assisted MLtd's fraud, and that they had any motive to do so.*

In addition to the previously discussed paragraphs of the Complaint, ¶¶ 7-17, 21, 62, 71, 98, and 101 also allege that the GT and MHM Defendants knew about and assisted MLtd's fraud. Nevertheless, "A showing of actual and complete knowledge of the [primary actor's fraud] is not … necessary to hold a secondary tortfeasor liable under an aiding and abetting theory." *Wells Fargo Bank v. Arizona Laborers, Teamsters & Cement Masons Local No. 395 Pension Trust Fund*, 201 Ariz. 474, 488, 38 P.3d 12, 26 (2002). "[S]uch knowledge may be inferred from the circumstances." *Id.* at 485, 38 P.3d at 23 (citing *In re American Cont'l Corp./Lincoln Sav. & Loan Sec. Litig.*, 794 F. Supp. 1424, 1436 (D. Ariz. 1992)). "Moreover, substantial assistance does not mean assistance that is necessary to commit the fraud. The test is whether the assistance makes it 'easier' for the violation to occur, not whether the assistance was necessary." *Wells Fargo*, 201 Ariz. at 489, 38 P.3d at 27 (citations omitted).

The allegations about GT's preparation of the July 2006 POM, which included MHM's 2004-05 audit reports "constitute[] 'substantial assistance.'" *Oster v. Kirschner*, 905 N.Y.S.2d 69, 72 (App. Div. 2010) (recognizing that the POMs that the attorneys prepared were the "vehicle by which the Ponzi scheme was carried out.") (also holding that an attorney's knowing nondisclosure in a POM of management's crimes is a material omission that shows both the knowledge and assistance needed for aiding and abetting); *accord Grand v. Nacchio*, 225 Ariz. 171, 236 P.3d 398 (2010), (recognizing that third-party assistance in preparing a misleading document that an issuer uses to solicit investments amounts to statutory participation of securities fraud). For a more detailed discussion about what facts are needed to adequately plead knowledge and substantial assistance, and how the facts about GT's and MHM's acts and omissions regarding MLtd's operations, financial condition, relationship with RB and illegal sales that are discussed above and pleaded in VR's Complaint are sufficient to support VR's claims

of GT's and MHM's aiding and abetting MLtd's fraud, *see* Ex. 1 at 6-7, 24-28; Ex. 2 at 15-17; Ex. 4 at 20-22, 25.

- *Which specific wrongful acts or omissions are attributable to which individual Defendant, as opposed to lumping all Defendants together (as well as all GT and MHM Defendants together in two groups).*

"[T]here is no absolute requirement that where several defendants are sued in connection with an alleged fraudulent scheme, the complaint must identify false statements made by each and every defendant." *Swartz v. KPMG, LLC*, 476 F.3d 756, 764 (9th Cir. 2007). "[P]articipation by each conspirator in every detail in the execution of the conspiracy is unnecessary to establish liability …." *Beltz Travel Serv., Inc. v. Int'l Air Transp. Ass'n*, 620 F.2d 1360, 1367 (9th Cir.1980). Suffice it to say that as in *U.S. Bank Nat'l Ass'n v. Franulovic*, No. 03-1150-HA, 2007 WL 1598091, *3 (D. Or. June 1, 2007), the paragraphs of the Complaint cited and discussed above do identify which specific wrongful acts or omissions are attributable to which Defendant. The only reason that in many allegations all Defendants are collectively named is that VR believes, and the evidence so far certainly indicates, that all of the Defendants were complicit in such wrongful acts or omissions. Of course, VR could have repeated each of those allegations for each Defendant, but to do so would have substantially and unnecessarily increased the length of the Complaint and the number of its paragraphs, which in VR's opinion would have violated Rule 8(a)'s requirement for a "short and plain statement of the claim." However, if the Court disagrees and believes that further separation is required, VR will amend its Complaint accordingly.

As for the GT Defendants, ¶¶ 7, 11, 12, 50 and 56 of the Complaint, for example, demonstrate that all of the named GT Defendants are responsible and vicariously liable for the wrongful acts and omissions of their individually named attorneys, Kant and Verbin under the principle of *respondeat superior*. As for the MHM Defendants, ¶¶ 8-10, 13, 14 and 81 of the Complaint, for example, demonstrate that it was proper to, as MHM asserts, "lump" them all together, because under the principles of principal and agent, parent and wholly owned and controlled subsidiaries, and respondeat superior, all of the named MHM Defendants are responsible

and vicariously liable for the wrongful acts and omissions of their individually named auditor, McLane, and supervisor, Kramer. In the cited paragraphs, the Complaint alleges that all of the accountants who performed auditing work for Mayer Hoffman, including McLane and Kramer, were Mayer Hoffman, CBIZ and CBIZ MHM employees and that CBIZ was a publicly traded company, which meant it could not perform audits in its own name, but had to use Mayer Hoffman auditors. As for Denning, in addition to the allegations discussed above, ¶¶ 15, 56 and 69 of the Complaint, for example, delineate his specific involvement. For a more detailed discussion about this, *see* Ex. 1 at 17, 20-21, 24-28; Ex. 2 at 15; Ex. 3 at 6, 10, 11.

- *How Defendants plausibly knowingly participated in a fraud on the VR Investors.*

All of the above allegations show the plausibility of each of these Defendants' knowing participation in a fraud on the VR Investors. Moreover, ¶¶ 28, 37-40, 42, 44, 50-59, 61-63, 65-66, 70-72, 78-79, 81-83 of the Complaint VR allege and describe the following fraudulent conduct:

1. Denning's misrepresentations (including nondisclosures) made to the VR Investors with GT's and MHM's knowledge about MLtd, MLS, the RevOp Loan Program and MLtd/MLS's compliance with all securities laws;

2. MLtd's inability to fund millions of dollars of its loans to developers for several projects and inability to repay investors, which all Defendants knew about;

3. MLtd's Ponzi scheme, which all Defendants knew about and were a part of; MLtd's involvement with RB, which all Defendants knew about and knew was illegal;

4. how GT's July 2006 POM and MHM's 2004-05 audit reports were false and misleading, did not fairly represent or disclose various facts about MLtd, its sources of revenue, financial condition, contingent liabilities, operations, mortgage loans, personal loan guarantees and involvement with RB, which all the Defendants knew about;

5. how GT's July 2006 POM omitted certain adverse disclosures that had been made in previous POMs, which led investors to believe that those adverse matters had been resolved;

6. Defendants' failure to disclose to investors that MLtd needed millions of dollars to pay interest to sustain its business, that MLtd rewrote hundreds of millions of dollars of old

loans or sold new loans to hide borrower defaults, that MLtd was concentrating its loans in fewer loans of larger amounts, that MLtd's senior management had increasing concern about these matters and MLtd's delayed-funding problems, that MLtd's debt burden forced it to terminate the RevOp Loan Program;

7. MLtd's efforts, with all of the Defendants' assistance, to hide how bad its financial condition was;

8. GT's advice to MLtd that it did not have to disclose any of the above problems to investors, to change certain provisions in its agreements with investors to further protect MLtd from liability for borrower defaults, to file new UCC-1s to subordinate three VR Investors' RevOp interests in trust deeds to RB's so MLtd could raise more money from RB.

So, as noted above, it is difficult to understand what Complaint Defendants are talking about because VR's Complaint clearly identifies and describes in detail the wrongful acts and omissions of each of them and how those acts and omissions damaged VR's Investors and support VR's claims. As discussed in great detail in the applicable portions of the attached exhibits, VR's Complaint is sufficient. In addition, the following sections address Defendants' contentions about each individual part of Count One of the Complaint.

1. <u>Common Law Fraud</u>

"The elements of common law fraud are a material, false representation, scienter, the fraudfeasor's intent to induce reliance upon the misrepresentation, the fraud victim's ignorance of its falsity, his actual, reasonable reliance, and his consequent and proximate injury." *Parks v. Macro-Dynamics, Inc.*, 121 Ariz. 517, 520, 591 P.2d 1005, 1008 (App. 1979). "No formal language is necessary, so long as all the elements of fraud are found in the complaint as a whole." *Id.* VR's Complaint pleads all of these elements of common law fraud in ¶ 101-103 and 106, and the specific acts and omissions constituting the misrepresentations and the scienter of each Defendant, as well as the VR Investors' reasonable reliance on and ignorance of the misrepresentations, are pleaded and discussed in the paragraphs of the Complaint cited above. Therefore, VR's Complaint, as a whole, is sufficient and Defendants arguments that VR's allegations of common law fraud are deficient has no merit. *See also*, Ex. 4 at 25-26.

2. A.R.S. § 13-2310

Defendants argue that A.R.S. § 13-2310 provides no basis for civil liability for statutory fraud. MHM adds, "Nor would Arizona courts infer an implied action." *MHM Response* at 20. However, Arizona case law amply demonstrates just the opposite, that the statute does provide the basis for civil liability for its violation. For example, *Rhue v. Dawson*, 173 Ariz. 220, 841 P.2d 215 (App. 1992), affirmed a judgment for treble damages in a civil action for violation of the statute. In *Ness v. Western Sec. Life Ins. Co.*, 174 Ariz. 497, 851 P.2d 122 (App. 1992), the trial court's summary judgment against the defendant on the plaintiff's claim for statutory fraud under A.R.S. § 13-2310 was reversed not because no such action could be brought, but because the plaintiff did not present prima facie evidence of a scheme or artifice to defraud. By its holding, the appellate court clearly recognized the existence of such a private cause of action under the statute.

Finally, in *Pearce v. Stone*, 149 Ariz. 567, 720 P.2d 542 (App. 1986), the court reversed summary judgment entered against a plaintiff on his claim of statutory fraud against a judgment debtor's lawyer under A.R.S. § 13-2310. The court also recognized that the statute was also the basis for the plaintiff's conspiracy claim against the lawyer based on the lawyer's making it possible for his client to fraudulently convey real property by drafting a trust document that allowed the client to convey the property to the trust.

So, contrary to Defendants' arguments, Arizona case law clearly supports the use of A.R.S. § 13-2310 as the basis for a private cause of action for statutory fraud, as well as for civil conspiracy. But even if it did not, in light of the Arizona Supreme Court's recent decision in *Grand v. Nacchio*, 225 Ariz. 171, 236 P.3d 398 (2010), which was rendered after VR filed its Complaint, VR intends to amend its Complaint, which it has a right to do as a matter of course without leave of the Court since none of the Defendants have filed responsive pleadings to its Complaint, to add claims of statutory securities fraud against all Defendants under A.R.S. §§ 44-1991(A), 44-1999(B) and 44-2003(A) of the Arizona Securities Act ("ASA"), like those alleged in the *Facciola* and *Ashkenazi* complaints, which are discussed in detail in Ex. 1 at 3-29, Ex. 2 at 12-17, Ex. 3 at 6-10, and Ex. 4 at 17-22.

Even without such an amendment, violations of those statutes already can be inferred from the facts alleged in VR's present Complaint and provide yet a further basis for VR's statutory fraud claims. In particular, if A.R.S. § 44-1991(A)(3) is substituted for A.R.S. § 13-2310 in the present Complaint, it states another basis for statutory fraud in its present form. *See Grand* at 174, 236 P.3d at 401 ("44-1991(A)(3), for example, makes it illegal for any person 'directly or indirectly' to '[e]ngage in any transaction, practice or course of business which operates or would operate as a fraud or deceit.'). But in an amended complaint, VR will allege other claims under the ASA with the requisite factual support.

3. <u>Consumer Fraud</u>

Defendants are correct that a claim for consumer fraud under A.R.S. §§ 44-1521 and -1522 is subject to a one-year statute of limitations and that VR's Complaint only alleges that the VR investors became aware that it could bring such a cause of action sometime after MLtd's bankruptcy case began. Defendants are also correct, of course, that the VR investors knew or should have known about MLtd's fraud when MLtd filed bankruptcy in late June 2008. VR also acknowledges that MLtd's 2006 Private Offering Memorandum ("POM"), which included the MHM's 2004 and 2005 audit reports of MLtd's financial statements, put the VR investors on notice that GT prepared that POM and that MHM prepared those audit reports.

But that does not mean that the VR investors knew, and, in fact, they did not know, about GT's or MHM's wrongdoing in preparing that POM or audit reports or that they had any complicity in MLtd's fraud, including the consumer fraud, until on or about January 21, 2009, when the Official Committee of Investors ("the Committee") filed its first Disclosure Statement in support of its proposed Plan of Reorganization of MLtd, which for the first time, listed and made known to the VR Investors that there were potential causes of action against various third-party professionals, including MLtd's lawyers, accountants and auditors, for the losses they incurred as the result of their involvement with, and acts performed for, MLtd. Through inadvertence, VR failed to include specific allegations stating the facts about the January 21st Committee Disclosure Statement, but if necessary, that omission can easily be rectified by VR's amending its Complaint to include such allegations.

Regardless, the present Complaint, on its face, does not indicate that a consumer fraud basis for Count One is time-barred since it does not state that the VR investors knew about GT's or MHM's complicity one year prior to when the tolling period began, which began on December 15, 2009, as the result of GT's and MHM's having entered into tolling agreements with the VR investors. As GT and MHM acknowledge, the present Complaint alleges that they agreed to toll the applicable statutes of limitations for all of VR's claims between December 15, 2009 (less than 11 months after any claims against GT and MHM accrued) and May 21, 2010 when the VR investors effectively terminated the tolling agreements (Compl. ¶ 18). VR filed its Complaint against GT and MHM on June 1, 2010 just 11 days after that, which was still within the statutory one-year time limit for consumer fraud.

Whether or not the VR Investors should have known that they had claims against GT and MHM before the Committee filed its Disclosure Statement is a question of fact that cannot be decided on a motion to dismiss. *See Rothman v. Gregor*, 220 F.3d 81, 98 (2d Cir. 2000) However, VR agrees that a consumer fraud claim against Denning is time-barred since he was not a party to the tolling agreements and the time for such a claim against him and the other MLtd officers ran out probably in June of 2009.

GT (but not MHM) also argues that there is no Arizona precedent for aiding and abetting consumer fraud. Although there is one unpublished decision, which by rule, VR cannot cite, that recognized such a cause of action, there also is no Arizona authority that prohibits such a cause of action. GT cites a case under Arizona's Uniform Fraudulent Transfer Act that holds there is no cause of action for aiding and abetting its violation, so by analogy, there is no cause of action for aiding and abetting a violation of Arizona's consumer fraud statute. However, the more analogous Act is the Arizona Securities Act, which prohibits similar fraudulent conduct, and as discussed in Ex. 4 at 20-23, 26, a claim for aiding and abetting exists for violations of that Act even though it does not expressly state that.

Regardless, once again GT ignores the plain language of the Complaint, which clearly states that Defendants' "false pretenses, fraudulent misrepresentations and omissions also ***constitute statutory fraud*** **or** ***aiding and abetting statutory fraud*** as … consumer fraud …."

(Compl. ¶ 105 (emphasis added)). So, even if there is no cause of action for aiding and abetting consumer fraud, that does not mean that GT can escape liability for committing and/or participating in such fraud as opposed to assisting another's fraud. Again, whether GT (and MHM) were primary, direct participants in MLtd's fraud or secondary participants as aiders and abettors will turn on the evidence garnered from discovery and presented at trial and determined by the jury as questions of fact.

B. COUNT TWO (Negligence/Negligent Misrepresentation)

Both GT and MHM argue that this claim fails because VR's Complaint does not sufficiently plead that either had a duty to the VR Investors or their reliance on any alleged misrepresentations. Denning merely argues that his alleged misrepresentations are not sufficiently identified in the Complaint.

In Arizona, Restatement (Second) of Torts § 552 (1977) governs negligent misrepresentation claims against professionals such as auditors and lawyers. *Standard Chartered PLC v. Price Waterhouse*, 190 Ariz. 6, 30, 945 P.2d 317, 342 (App. 1996). "The tort of negligent misrepresentation, as defined in section 552, encompasses negligence both in gathering and communicating information." *Id.* 30-31, 945 P.2d at 341-42 (citing § 552 cmt. e). As previously discussed, VR's Complaint describes in detail Defendants' negligence in both gathering and communicating the information about MLtd and its RevOp Loan Program to the VR Investors.

Reliance on the misrepresentations is certainly an element and Defendants' arguments about that element and what representations were false have already been discussed in the previous sections and need not be repeated here. The GT and MHM Defendants' also argue that VR's negligent misrepresentation claim fails because they had no duty to the VR Investors. As for GT's and MHM's duty, Arizona law provides that a professional owes a duty to a third party "when the professional (1) intends to supply information for the benefit of the third party or (2) knows that the recipient of the information intends to supply the information to the third party." *Sage v. Blagg Appraisal Co.*, 221 Ariz. 33, 36, 209 P.3d 169, 172 (App. 2009) (citing Restatement (Second) Of Torts § 552(1), (2)(a) (1977)).

That is precisely what VR's Complaint alleges. "[T]he Restatement does not require that

the professional know for a certainty that the statement will be furnished to a third party." *Sage* at 38, 209 P.3d at 174. Section 552 "requires only that the professional know that the recipient of the statement . . . intends to furnish the statement to another." *Id*. Again, VR's Complaint clearly alleges that both GT and MHM knew that the July 2006 POM and all of audit reports were prepared for MLtd with the intent that MLtd would provide them to the VR Investors.

MHM's asserts that VR's negligent misrepresentation claim fails because its audits were performed for MLtd for "general corporate purposes" rather than to give to investors, that VR cannot show that the VR Investors were intended recipients, and therefore, MHM had no duty to them. (*MHM Motion* at 23-24). Those assertions fly in the face of the applicable case law discussed herein, as well as the allegations of the Complaint discussed above, which unambiguously state that MHM knew that its 2004-2005 audit reports would be included as part of the July 2006 POM, and that MLtd would provide all of its audit reports and the financial states MHM reviewed and helped prepare to investors, including the VR Investors, with MHM's consent.

In addition to the principles set out in *Sage* and *Standard Chartered*, *supra*,

> "The Restatement [§ 552] states that the supplier of information need not know the actual identities of the intended beneficiaries, but only their general nature, such … investors. The Restatement also implies that if a client tells his accountant that he intends to use the financial statements to recruit investors, ***then the accountant is liable to <u>any investor</u> for material misstatements in the audited statements***.

Hayes v. Arthur Young & Co., 34 F.3d 1072, 1994 WL 463493, *15 (9th Cir. 1994) (emphasis added) (footnotes omitted).

Again, MHM knew that its audit reports would be included in the POM provided to the VR Investors, and as noted above, that POM was by its nature a solicitation to the VR Investors to invest in the RevOp Loan Program. *O'Melveny*, 969 F.2d at 746-49. The allegations of VR's Complaint meet all the requirements of § 552 and therefore, are sufficient to state a cause of action for negligent misrepresentation against the MHM Defendants. Moreover, in these circumstances, auditors, such as MHM, have a statutory duty to conduct their audits "in accordance with generally accepted auditing standards [GAAS]" so as to be able "to detect illegal acts and to identify and disclose related-party transactions, and to make going-concern evalu-

ations. A.R.S. § 44-2122. Again, the Complaint provides more than enough facts to establish that MHM failed to meet this duty. For a further discussion of MHM's liability for negligent misrepresentation to MLtd's investors, *see* Ex. 2 at 2-3, 5, 14-21; Ex. 4 at 30-32.

GT's assertions that it had no duty to the VR Investors because they were not GT's clients also flies in the face of established legal principles. Again, the Complaint alleges that GT's attorneys, Kant in particular with Verbin's supervision, prepared the July 2006 POM. Again, *O'Melveny* demonstrates that by doing so, they had a duty to the VR Investors conduct a "reasonable, independent investigation to detect and correct false or misleading materials." *Id.* at 749. As the Complaint alleges, they did not do this, and therefore, if those allegations are proven, they are liable to the VR Investors.

Arizona follows the Restatement (Third) of the Law Governing Lawyers (1998) regarding causes of action by non-client third-parties against attorneys. *See, e.g., Chalpin v. Snyder*, 220 Ariz. 413, 424, 207 P.3d 666, 677 (App. 2008). Contrary to GT's assertions, under Arizona law and the Restatement, a lawyer "has a duty to third parties who are foreseeably injured by the lawyer's negligent actions." *Paradigm Ins. Co. v. Langerman Law Offices, P.A.*, 200 Ariz. 146, 154, 24 P.3d 593, 601 (2001) (holding that a lawyer owes a duty of care to a nonclient and may be liable for negligent breach of that duty). And, again, privity between the lawyer and a nonclient third party is not required. *Id.*; *see also Kremser v. Quarles & Brady, L.L.P.*, 201 Ariz. 413, 417, 36 P.3d 761, 765 (App. 2001) (reversing dismissal of nonclient's complaint against corporation's lawyers, holding that under Restatement (Third) of The Law Governing Lawyers, § 51(2 and 3), lawyers owed a duty of care to nonclient debt holders and their complaint alleged facts that stated a claim that lawyers breached their duty of care).

Moreover, contrary to GT's erroneous assertions that the rules of ethics (*Arizona Rules of Professional Conduct*, Rule 42, Sup. Ct. Rules, 17A A.R.S.) have no relevance to a lawyer's duty to nonclient third parties, a violation of an ethics rule ("ER") is evidence of malpractice, *Elliott v. Videan*, 164 Ariz. 113, 116,791 P.2d 639, 642 (App. 1989), and can be used as the basis for finding that a lawyer's conduct of assisting or participating in his client's fraud resulted in actionable harm to a nonclient, *see, e.g., In re American Cont'l*, 794 F. Supp. at 1452

(citing ER 1.16). Furthermore, the section of the Preamble to the ERs that GT quotes (*GT Motion* at 19) also says that "since the Rules establish standards of conduct by lawyers, a lawyer's violation of a Rule may be ***evidence of breach of the applicable standard of care***." Ariz. R. Prof. Conduct, Preamble ¶ 20 (2010) (emphasis added).

In addition, as alleged in ¶ 110 of the Complaint, ER 1.2(d) prohibits an attorney from participating in a client's fraud, and in circumstances like those alleged in VR's Complaint, if a client (like MLtd) refuses to end its fraudulent conduct, the attorney (like the GT attorneys) must disclose the fraud to avoid assisting the fraud through continued representation pursuant to ER 4.1(b), which also prohibits an attorney from "knowingly: … mak[ing] a false statement of material fact or law to a third person." Finally, ER 2.3, cmt. 4, expressly provides, "When the evaluation is intended for the information or use of a third person, a legal duty to that person may or may not arise." In the circumstances alleged in the Complaint, such a duty clearly arose. *See also* Ex. 1 at 35 for further discussion of GT's liability for negligent misrepresentation to MLtd's investors.

C. COUNT THREE (Aiding and Abetting MLtd's Breaches of Contract)

Based on Defendants' argument that Arizona does not recognize a claim for aiding and abetting breach of contract, VR hereby withdraws and will delete this claim from the amended complaint that it intends to file.

D. COUNT FOUR (Aiding and Abetting MLtd's Bad Faith)

GT and Denning argue that Count Four fails because a cause of action for aiding and abetting a breach of good faith and fair dealing is not recognized in Arizona. (*GT Motion at 21*; *Denning Motion* at 10). However, that is not true. Arizona courts do recognize such a claim. *See, e.g., Chalpin v. Snyder*, 220 Ariz. at 424, 207 P.3d at 677 (reversing trial court's dismissal of plaintiff's complaint that included a claim for aiding and abetting tort of bad faith); *see also Morrow v. Boston Mut. Life Ins. Co.*, No. CIV 06-2635-PHX-SMM, 2008 WL 220754, *1 (D. Ariz. Jan 24, 2008) (recharacterizing plaintiff's aiding and abetting breach of fiduciary duty as one for aiding and abetting bad faith); *Id.*, 2007 WL 4335486, *2 (Dec. 7, 2007) (setting out elements of proof for claim of aiding and abetting bad faith, which was a viable cause of

action); *Id.*, 2007 WL 3287585, *6 (Nov. 5, 2007) (denying motion to dismiss aiding and abetting bad faith claim because "[t]he Complaint sets forth a prima facie case against Defendants for aiding and abetting bad faith.").

MHM also argues that since Count Four arises fraud and VR's fraud claims fail, Court Four also fails. (*MHM Motion* at 12-14, 31-33). However, as discussed above, VR's fraud claims have been sufficiently pleaded, and therefore, this argument lacks any merit.

E. COUNT FIVE (Aiding and Abetting MLtd's Breaches of Fiduciary Duty)

GT and Denning argue that this Count fails because the Complaint does not sufficiently allege knowledge of or substantial assistance in MLtd's breaches of fiduciary duty. (*GT Motion* at 22-24; *Denning Motion* at 10-11). The allegations pertaining to the elements of knowledge and substantial assistance required to be alleged for this claim are discussed in detail above in regard to Defendants' arguments about the allegations of aiding and abetting fraud. That discussion is equally applicable and incorporated here (and to all of VR's aiding and abetting claims).

To summarize, "such knowledge may be inferred from the circumstances." *Wells Fargo*, 201 Ariz. at 485, 38 P.3d at 23; *accord YF Trust*, 2008 WL 821856 at *5 ("knowledge may be inferred from the circumstances"). The allegations about GT's and MHM's preparation of the July 2006 POM and 2004-05 audit reports "constitute[] 'substantial assistance.'" *Oster v. Kirschner*, 905 N.Y.S.2d 69, 72 (App. Div. 2010). In other words, "the knowledge requirement may be satisfied by showing general awareness of the primary tortfeasor's fraudulent scheme." *Dawson v. Withycombe*, 216 Ariz. 84, 102, 163 P.3d 1034, 1052 (App. 2007). *See also* Ex. 1 at 32; Ex. 4 at 27.

The MHM Defendants argue that this Count fails because, in addition to VR's not alleging their knowledge of MLtd's breaches of fiduciary duty, they had no motive to assist MLtd's breaches, and that VR's claim arises out of fraud, which has not been sufficiently pleaded under Rule 9(b). (*MHM Motion* at 4, 14, 30). None of the cases MHM cites says that motive has to be pleaded as a required element, or that a heightened pleading standard applies to a claim for aiding and abetting claims outside of securities law context. Regardless, as discussed above, VR has pleaded fraud with the requisite particularity.

F. COUNT SIX (Civil Conspiracy)

GT argues that this Count fails because VR's Complaint does not allege that any GT Defendant consciously agreed with anyone to intentionally defraud VR's Investors and that the Complaint does not identify any underlying tort that was committed. (*GT Motion* at 25-26). The MHM Defendants argue that this Count fails because, again it is dependent on VR's fraud claims, which have not been sufficiently pleaded, that the Complaint does not detail the scope of the alleged conspiracy, and that they had any motive to enter into a conspiracy. (*MHM Motion* at 15-16). Denning argues that the Complaint does not identify who he conspired with, the unlawful purpose of any such agreement that he engaged in specific acts to commit an unidentified underlying tort. (*Denning Motion* at 8).

As with VR's other claims, all of these purportedly missing allegations "may be inferred from the [allegations discussed above that demonstrate] the nature of the acts, the relationship of the parties, 'the interests of the conspirators, or other circumstances' …." *Mohave Elec. Co-op., Inc. v. Byers*, 189 Ariz. 292, 306, 942 P.2d 451, 465 (App. 1997) (quoting *In re American Cont'l,* 794 F. Supp. at 1437); *accord Vasquez v. City of Phoenix*, No. CV-04-481-PHX-DGC, 2006 WL 1147716, *4 (D. Ariz. May 1, 2006); *see also Pearce v. Stone*, *supra* (recognizing plaintiff judgment creditor's conspiracy claim against lawyer based on lawyer's drafting trust agreement that allowed judgment debtor client to fraudulently convey real property to trust).

III. CONCLUSION

For the above reasons, GT's, MHM's and Denning's motions to dismiss VR's Complaint should be denied, except the consumer fraud claim in Count One against Denning and except for Count Three, which VR hereby withdraws. However, in the event the Court disagrees and finds that VR's Complaint is factually deficient as for any of the other Counts and claims, the Court should allow VR a reasonable amount of time to amend its Complaint to remedy any such deficiencies.

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RESPECTFULLY SUBMITTED this 12th day of October, 2010.

/s/ William A. Miller
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Attorney for Plaintiff

CERTIFICATE OF SERVICE

I hereby certify that on October 12, 2010, I electronically filed the foregoing with the Clerk of the Court using the Court's CM/ECF system, which will send notification of such filing to all parties of record in this case.

/s/ William A. Miller
William A. Miller
Attorney for Plaintiff