Marty Harper (AZ #003416)
Katherine V. Brown (AZ #026546)
POLSINELLI SHUGHART PC
3636 North Central Avenue, Suite 1200
Phoenix, Arizona 85012
Telephone: (602) 650-2000
Facsimile: (602) 264-7033
E-Mail: mharper@polsinelli.com
E-Mail: kvbrown@polsinelli.com
Local Counsel

David F. Adler (Ohio #0037622)
James R. Wooley (Ohio #0033850)
Louis A. Chaiten (Ohio #0072169)
Eric E. Murphy (Ohio #0083284)
Katie M. McVoy (Ohio #0080860)
JONES DAY
Northpoint
901 Lakeside Avenue
Cleveland, Ohio 44114
Telephone: (216) 586-3939
Facsimile: (216) 579-0212
Of Counsel (admitted pro hac vice)

Attorneys for Defendants
CBIZ, Inc., CBIZ MHM, LLC,
Mayer Hoffman McCann PC,
Charles A. and Eileen M. McLane,
and Joel B. and Donna L. Kramer

IN THE UNITED STATES BANKRUPTCY COURT

THE DISTRICT OF ARIZONA

In re: Mortgages, Ltd., Debtor.	Chapter Proceedings Case No. 2:08-bk-07465-RJH

VICTIMS RECOVERY, LLC, an Arizona limited liability company,

Plaintiff,

GREENBERG TRAURIG LLP, et al.

Defendants.

Adversary Case No. 2:10-ap-01214-RJH

JOINT MEMORANDUM IN SUPPORT OF MOTION TO DISMISS COMPLAINT OF DEFENDANTS CBIZ, INC., CBIZ MHM, LLC, MAYER HOFFMAN MCCANN P.C., CHARLES A. AND EILEEN M. MCLANE, AND JOEL B. AND DONNA L. KRAMER

TABLE OF CONTENTS

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Pages

Cases

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES

Pages

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES

Rules

Statutes

Miscellaneous

INTRODUCTION

Victims Recovery, LLC ("VR"), brings this suit against former managers and outside professionals of Mortgages, Ltd. ("ML"). (Doc. 1, Notice of Removal, Ex. A., Compl. ¶ 1 (hereinafter "Compl.").) It has obtained an assignment of claims from eighteen investors ("VR Investors") who invested over $52 million in ML's Revolving Opportunity ("RevOp") Loan Program beginning in 2004. (*Id.* ¶¶ 1, 3.) Under that program, the VR Investors bought fractional interests in loans ML made to real-estate developers. (*Id.* ¶ 23.) To induce their participation, ML allegedly made false statements to the VR Investors, failing to disclose, among other things, that it was undertaking "Ponzi schemes" in which it used their funds to pay off old investors. (*Id.* ¶ 40.) By 2008, the alleged Ponzi scheme collapsed and ML defaulted on its commitments to the VR Investors. (*Id.* ¶ 42.) VR seeks to recover the lost investments from third parties, including the so-called "MHM Defendants," namely, Mayer Hoffman McCann P.C. ("Mayer Hoffman"), CBIZ, Inc. ("CBIZ"), CBIZ MHM, LLC ("CBIZ MHM"), Charles McLane (and his wife Eileen McLane), and Joel Kramer (and his wife Donna Kramer). (*Id.* ¶ 21.)

None of these Defendants had any contact with VR Investors. As for Mayer Hoffman, it undertook annual audits of ML's financial statements. (*Id.* ¶ 8.) ML allegedly attached at least some of Mayer Hoffman's audit reports to Private Offering Memoranda ("POMs") that ML gave to some investors. (*Id.* ¶ 76.) At bottom, the Complaint alleges that these reports misstated that ML's financial statements reflected its financial health and comported with Generally Accepted Accounting Principles ("GAAP"), and that Mayer Hoffman's audit followed Generally Accepted Auditing Standards ("GAAS"). (*Id.* ¶ 78.) As for the other Defendants, VR conclusorily alleges that CBIZ and CBIZ MHM controlled Mayer Hoffman. (*Id.* ¶¶ 9-10.) McLane, an employee of Mayer Hoffman and CBIZ, allegedly was the "primary person" who "aided and abetted" their services. (*Id.* ¶ 13.) Kramer worked with or supervised McLane. (*Id.* ¶ 14.)

VR asserts six counts against these Defendants: (1) common law and statutory fraud (*id.* ¶¶ 100-06); (2) negligence (*id.* ¶¶ 107-09, 112-15); (3) aiding and abetting ML's breach of contract (*id.* ¶¶ 116-21); (4) aiding and abetting ML's bad faith (*id.* ¶¶ 122-26); (5) aiding and abetting ML's breach of fiduciary duties (*id.* ¶¶ 127-31); and (6) conspiracy (*id.* ¶¶ 132-35). These claims fail, however, for multiple, independent reasons.

Rule 9(b). All claims against these Defendants that are based on VR's fraud allegations must be dismissed for failure to plead with the particularity required by Federal Rule of Civil Procedure 9(b). Far from pleading with particularity, the Complaint simply "lump[s] [these] multiple defendants together." *Derry v. Am. Brokers Conduit*, No. CV09-2549-PHX-NVW, 2010 WL 432340, at *2 (D. Ariz. Feb. 2, 2010). (*See* Compl. ¶¶ 21, 98.) It makes "conclusory allegations" that CBIZ, CBIZ MHM, McLane, and Kramer participated in fraud, which also "fail to satisfy [Rule] 9(b)." *Hearn v. R.J. Reynolds Tobacco Co.*, 279 F. Supp. 2d 1096, 1113 (D. Ariz. 2003). And, as for Mayer Hoffman, the Complaint fails to "specify which [VR Investors] received which [of its audit reports]," *Moore v. Kayport Package Exp., Inc.*, 885 F.2d 531, 540 (9th Cir. 1989), and "which [reports] [each VR Investor] relied upon," *Kearns v. Ford Motor Co.*, 567 F.3d 1120, 1126 (9th Cir. 2009). Accordingly, the four counts against these Defendants that rely on the alleged "course of fraudulent conduct," *Vess v. Ciba-Geigy Corp. USA*, 317 F.3d 1097, 1103 (9th Cir. 2003)—including the fraud count, the counts alleging aiding and abetting ML's bad faith and breach of fiduciary duties, and the conspiracy count—must be dismissed.

Fraud. VR's fraud count also fails for reasons independent of Rule 9(b). To begin with, it does not plausibly establish that Mayer Hoffman, CBIZ, CBIZ MHM, McLane, or Kramer acted with the requisite state of mind. While state of mind may be alleged generally, the Complaint still "must afford a basis for believing that [VR] could prove scienter," *DiLeo v. Ernst*

& *Young*, 901 F.2d 624, 629 (7th Cir. 1990), by "set[ting] forth *specific facts* supporting an inference of fraud," *Melder v. Morris*, 27 F.3d 1097, 1102 (5th Cir. 1994). It does not. It asserts "nothing more than rote conclusions" that Defendants knew of the alleged falsities. *Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1127 (7th Cir. 1990). As for specific claims, VR's alleged accounting errors and violations of GAAP cannot establish scienter. *In re Software Toolworks Inc.*, 50 F.3d 615, 627 (9th Cir. 1994). That is especially the case because VR has asserted no facts that these Defendants had any motive to participate in the fraud. *DiLeo*, 901 F.2d at 629.

In addition, any fraud claim under A.R.S. § 13-2310 fails because that provision does not authorize civil suits. (Compl. ¶ 105.) It "was adapted from the federal mail fraud statute," *State v. Haas*, 675 P.2d 673, 678 (Ariz. 1983), which does "not confer private rights of action." *Ateser v. Bopp*, Nos. 92-36869, 92-36964, 1994 WL 377872, at *2 (9th Cir. July 19, 1994). Since no civil action exists under federal law, no action exists under § 13-2310(A). *Haas*, 675 P.2d at 678.

Finally, the statute of limitations has run on any consumer-fraud claim under A.R.S. § 44-1522. Actions under that statute must be brought within one year of the date the plaintiff knew or should have known of fraud. *Cervantes v. Countrywide Home Loans, Inc.*, No. CV 09-517-PHX-JAT, 2009 WL 3157160, at *7 (D. Ariz. Sept. 24, 2009). Here, the VR Investors should have known of the alleged fraud no later than June 2008, when, according to the Complaint, ML's Ponzi scheme "came crashing down," "forc[ing] [it] into bankruptcy." (Compl. ¶ 42.) The consumer-fraud claim is thus untimely.

Negligence. Arizona follows Restatement (Second) of Torts § 552 for negligent misrepresentation. (Compl. ¶ 108.) Under § 552, "an auditor retained *to conduct an annual audit* and to furnish an opinion for no particular purpose generally undertakes no duty to third parties." *Bily v. Arthur Young & Co.*, 834 P.2d 745, 758 (Cal. 1992) (emphasis added). That is

true even if the auditor "knows that the financial statements, accompanied by an auditor's opinion, are customarily used in a wide variety of financial transactions by the corporation and that they may be relied upon by lenders, investors, shareholders, creditors, purchasers and the like, in numerous possible kinds of transactions." Restatement (Second) of Torts § 552, illus. 10. Here, providing annual audits is all Mayer Hoffman did. (Compl. ¶ 75.) And, while VR repeatedly asserts that Mayer Hoffman knew its audit reports were for financing purposes (*id.* ¶¶ 74, 95, 112), those conclusory assertions must be disregarded, *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1951 (2009), and are insufficient in any event to satisfy § 552.

Nor has VR alleged facts plausibly establishing that each VR Investor relied on the reports. It asserts generically that the reports were "relied on by [the VR investors]." (Compl. ¶ 113.) But again, that conclusion does "not suffice." *Iqbal*, 129 S. Ct. at 1949. And it suggests only that "some or all of [the VR Investors]" received "some or all" the POMs that attached the reports. (Compl. ¶¶ 48, 76.) It does not allege *which* VR Investor received *which* report, if any.

Even if the claim against Mayer Hoffman were somehow viable, the Court would nonetheless have to dismiss CBIZ, CBIZ MHM, McLane, and Kramer. The Complaint seeks to recover based on statements in "[Mayer Hoffman]'s" "Auditors' Report[s]." (Compl. ¶ 75.) Since nothing in those reports attributes statements to CBIZ, CBIZ MHM, McLane, or Kramer, those Defendants supplied no information to ML or the VR Investors on which to base a negligent-misrepresentation claim.

Aiding-and-Abetting Claims. All aiding-and-abetting claims against Mayer Hoffman, CBIZ, CBIZ MHM, McLane, and Kramer must be dismissed because VR has not alleged "plausible grounds" that they *knowingly* assisted ML's unlawful acts. *Stern v. Charles Schwab & Co.*, No. CV-09-1229-PHX-DGC, 2010 WL 1250732, at *8 (D. Ariz. Mar. 24, 2010). Indeed,

VR has not established the scienter necessary for aiding and abetting for the same reasons it has not established the scienter necessary for fraud.

VR's count for aiding and abetting breach of contract, moreover, does not state a viable claim for an additional reason. "[A]iding and abetting [is a] derivative tort[] for which a plaintiff may recover only if it has adequately pled an independent primary tort." *AGA Shareholders, LLC v. CSK Auto, Inc.*, 589 F. Supp. 2d 1175, 1191-92 (D. Ariz. 2008). Thus, "aiding and abetting . . . cannot be rooted in breach of contract, which is not tortious conduct." *Covington v. Patriot Motorcycles Corp.*, No. CV-07-0955-PHX-FJM, 2007 WL 3208579, at *3 (D. Ariz. Oct. 29, 2007).

VR's count for aiding and abetting ML's breach of the implied covenant of good faith and fair dealing fails for the same reason. "[T]he remedy for breach of the implied covenant of good faith is ordinarily on the contract itself." *Rawlings v. Apodaca*, 726 P.2d 565, 574 (Ariz. 1986). A tort action is permitted only where the plaintiff contracted for its security rather than profit or where contract remedies would not deter a breach. *Beaudry v. Ins. Co. of the W.*, 50 P.3d 836, 842 (Ariz. Ct. App. 2002). Here, the VR Investors contracted with ML to obtain a profit. And they offer no grounds on which to conclude that contract remedies would be insufficient—indeed, they seek the same damages as they do for the breach of contract claim. Since only a contract action is available, VR cannot maintain a claim for aiding and abetting.

STATEMENT OF FACTS

As a mortgage broker established in 1963, ML originated, sold, and serviced "short-term bridge loans" to real-estate developers. (Compl. ¶¶ 20, 22.) To obtain the funding for these loans, ML sold fractional interests in them to private investors. (*Id.* ¶ 24.) The VR Investors invested in ML's RevOp Program, which gave them bundles of fractional interests. (*Id.* ¶¶ 4, 23.) The RevOp Program required these investors to invest large sums, and ML told them that,

in return, they received preferred positions and higher rates of return compared to other investors. (*Id.* ¶ 31.) ML also told them that they could get their investments back after ninety days or roll the investments over for another ninety-day period. (*Id.* ¶¶ 32, 34.)

By 2006, as a result of the weakening real-estate market, ML began to make larger and fewer loans, funding these loans in stages rather than all at once. (*Id.* ¶ 35.) Many developers, however, defaulted, causing a shortage of capital. (*Id.* ¶¶ 37-39, 41.) To remedy the lack of capital, ML allegedly turned to "Ponzi schemes" in which investments from new investors paid the interest due old investors and the company's business expenses. (*Id.* ¶ 40.)

During this time, the Complaint asserts, ML "perpetrat[ed] [] fraud on [its] investors." (*Id.* ¶ 62.) It allegedly made numerous false statements to induce the VR Investors to participate in the RevOp Program, including that ML never failed to pay back principal and that the investments would be paid back ahead of other investors. (*Id.* ¶¶ 28, 60-61, 83.) The "legal and financial documents" given to the VR Investors also allegedly contained false information. (*Id.* ¶ 26.) "[S]ome or all of the[] [investors] were provided some or all" of these documents, including the POMs related to the RevOp Program. (*Id.* ¶ 48.) A POM dated July 10, 2006, for example, was allegedly fraudulent because it failed to disclose, among other things, that ML was insolvent and was conducting a Ponzi scheme. (*Id.* ¶¶ 49-51.)

By late 2007 or early 2008, ML began to default on its interest payments and principal redemptions to the VR Investors. (*Id.* ¶¶ 40-42.) The alleged Ponzi scheme "came crashing down" in June 2008, when ML's CEO committed suicide and ML went into bankruptcy. (*Id.* ¶ 42.) All told, the VR Investors invested more than $52 million. (*Id.* ¶ 4.) VR now seeks to recover from third parties, including Mayer Hoffman, CBIZ, CBIZ MHM, McLane, and Kramer. The Complaint refers to those Defendants collectively as the "MHM Defendants." (*Id.* ¶ 21.)

The Complaint asserts that Mayer Hoffman "provided the auditing and accounting consulting services" for ML between 1998 and 2008. (*Id.* ¶¶ 8, 75.) Its audit reports allegedly contained false information. (*Id.*) The report for the 2004 and 2005 financial statements, for example, was included in the POM dated July 10, 2006. (*Id.* ¶ 76.) In that report, Mayer Hoffman indicated that ML's financial statements "fairly [presented] . . . the financial position" and were "in conformity with [GAAP]," and that its audit adhered to GAAS. (*Id.* ¶ 76.) The Complaint claims these statements were false. (*Id.* ¶¶ 78-82, 87-91.)

As for the other so-called "MHM Defendants," the Complaint lobs out a barrage of conclusory assertions. It alleges that CBIZ and CBIZ MHM "control[ed]" or "[were] otherwise affiliated with" Mayer Hoffman and "committed and performed services, participated in, enabled or aided and abetted, the acts and services performed by" Mayer Hoffman. (*Id.* ¶¶ 9-10.) McLane, a certified public accountant, was "an employee, shareholder, member or director of" Mayer Hoffman and CBIZ. (*Id.* ¶ 13.) He was the "primary person" responsible for Mayer Hoffman's "services." (*Id.*) Finally, Joel Kramer, another certified public accountant, was "managing director of the Phoenix offices of" Mayer Hoffman or CBIZ. (*Id.* ¶ 14.) He allegedly "worked with or supervised McLane in committing, participating in, enabling or aiding and abetting, the acts and performance of the services" of Mayer Hoffman. (*Id.*)

The Complaint alleges six counts against the "MHM Defendants." It first claims they committed common-law and statutory fraud by making false statements or material omissions (Count I). (*Id.* ¶¶ 100-106.) VR next asserts that these Defendants committed "negligence" by "failing to exercise reasonable care" in performing the audits, knowing that "such would be relied upon by the VR Investors" (Count II). (*Id.* ¶¶ 107-09, 112-15.) VR also suggests that they "aided and abetted [ML's] breaches of its . . . Agreements with the VR Investors" (Count III).

(*Id.* ¶¶ 116-21.) These agreements included "the implied covenants of fair dealing and good faith," and the Complaint asserts that the Defendants "aided and abetted" ML's breaches of those covenants (Count IV). (*Id.* ¶¶ 122-26.) As a result of the agreements, moreover, ML allegedly owed the VR Investors fiduciary "duties of disclosure, loyalty, good faith and fairness," and the "MHM Defendants" "aided and abetted [ML's] breaches of [those] duties" (Count V). (*Id.* ¶¶ 127-31.) Finally, the "MHM Defendants" allegedly "conspired" "to commit all or some of the fraudulent, unlawful and wrongful acts" (Count VI). (*Id.* ¶¶ 132-35.)

ARGUMENT

None of VR's counts against the so-called "MHM Defendants" can survive under controlling standards for a motion to dismiss. The Court must accept as true all well-pleaded facts, but not conclusory allegations. *Iqbal*, 129 S. Ct. at 1949. Thus, "[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice." *Id.* Further, the well-pleaded facts must show "plausible grounds" for every element. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 556 (2007). If, by contrast, the facts "are merely consistent with a defendant's liability," the complaint must be dismissed. *Iqbal*, 129 S. Ct. at 1949 (internal quotation marks omitted). Finally, VR's fraud allegations must be pleaded "with particularity." Fed. R. Civ. P. 9(b); Fed. R. Bankr. P. 7009. Here, the Court should dismiss Mayer Hoffman, CBIZ, CBIZ MHM, McLane, and Kramer from VR's lawsuit because the Complaint falls well short of meeting these standards.

I. MAYER HOFFMAN, CBIZ, CBIZ MHM, MCLANE, AND KRAMER MUST BE DISMISSED FROM ALL COUNTS THAT ARE BASED ON VR'S FRAUD ALLEGATIONS BECAUSE VR DOES NOT PLEAD THOSE ALLEGATIONS WITH THE PARTICULARITY REQUIRED BY RULE 9(B).

VR has not pleaded its fraud allegations against Mayer Hoffman, CBIZ, CBIZ MHM, McLane, and Kramer with the particularity required by Rule 9(b). As such, the Court should

dismiss these Defendants from all counts based on those fraud allegations, including not simply the common-law and statutory fraud count (Count I), but also the counts alleging aiding and abetting bad faith and breach of fiduciary duty (Counts IV-V) and conspiracy (Count VI).

A. VR Has Not Set Forth Its Fraud Allegations With The Required Specificity.

VR's fraud allegations do not satisfy Rule 9(b). That rule requires "a party [to] state with particularity the circumstances constituting fraud." Fed. R. Civ. P. 9(b). Thus, "allegations of fraud must be specific enough to give defendants notice of the particular misconduct which is alleged to constitute the fraud charged so that they can defend against the charge and not just deny that they have done anything wrong." *Bly-Magee v. California*, 236 F.3d 1014, 1019 (9th Cir. 2001) (internal quotation marks omitted). Fraud allegations, in other words, "must be accompanied by the who, what, when, where, and how of the misconduct charged." *Kearns*, 567 F.3d at 1124 (internal quotation marks omitted). Here, VR's Complaint seeks to hold the so-called "MHM Defendants" liable for allegedly false statements in annual audit reports over a six-year period. (Compl. ¶¶ 75-98.) Its allegations fall short of Rule 9(b)'s requirements in several important respects.

In the first place, the Complaint does not adequately allege the "who" of the fraud. *Kearns*, 567 F.3d at 1124. When discussing the fraud, it consistently lumps together Mayer Hoffman, CBIZ, CBIZ MHM, McLane, and Kramer as the "MHM Defendants." (*See, e.g.*, Compl. ¶¶ 21, 98). "This fails the Rule 9(b) test." *N'Genuity Enters. Co. v. Pierre Foods, Inc.*, No. 09-CV-00385-PHX-GMS, 2009 WL 2905722, at *12 (D. Ariz. Sept. 9, 2009). "'Rule 9(b) does not allow a complaint to merely lump *multiple defendants together* but requires plaintiffs to differentiate their allegations when suing more than one defendant and inform *each defendant separately* of the allegations surrounding his alleged participation in the fraud.'" *Derry*, 2010 WL 432340, at *2 (quoting *Swartz v. KPMG LLP*, 476 F.3d 756, 764-765 (9th Cir. 2007))

(emphases added); *see Tredennick v. Bone*, 323 Fed. App'x 103, 105 (3d Cir. 2008) ("[W]here multiple defendants are involved, the complaint should inform each defendant of the nature of his alleged participation in the fraud."); Wright & Miller, Federal Practice & Procedure § 1297 (3d ed. 2004) (citing cases). VR's decision to treat these separate Defendants as a single entity, therefore, mandates dismissal under unanimous law.

The Complaint also fails to allege the "what" of the fraud with respect to CBIZ, CBIZ MHM, McLane, and Kramer. *Kearns*, 567 F.3d at 1124. As for CBIZ and CBIZ MHM, it asserts only that they "committed and performed services, participated in, enabled or aided and abetted, the acts and services performed by" Mayer Hoffman. (Compl. ¶¶ 9-10.) As for McLane, it asserts that he was the "primary person who committed, participated in, enabled or aided and abetted, the acts and performance of the services . . . for MHM, CBIZ, CBIZ-MHM, [ML], [ML Securities], and [ML's CEO]." (*Id.* ¶ 13.) And the Complaint suggests that Kramer "worked with or supervised McLane." (*Id.* ¶ 14.) These conclusory allegations fail to satisfy even Rule 8, *Iqbal*, 129 S. Ct. at 1949, much less the more stringent requirements of Rule 9(b), *Moore*, 885 F.2d at 540. And since these allegations are the only ones that even attempt to say what specific role CBIZ, CBIZ MHM, McLane, and Kramer played, Rule 9(b) requires dismissal.

In addition, the Complaint does not identify the "when," "where," or "how" of the fraud that Mayer Hoffman allegedly perpetrated. *Kearns*, 567 F.3d at 1124. It generically asserts that, over a six-year period, Mayer Hoffman issued audit reports that contained false statements (Compl. ¶ 75), listing alleged errors in these various reports (*id.* ¶¶ 76-82, 87-92). VR, however, does not identify "the time, place, and content of the alleged misrepresentation *on which [each VR Investor] relied.*" *Bennett v. MIS Corp.*, 607 F.3d 1076, 1100 (6th Cir. 2010) (emphasis added). Alleging a false statement in the abstract, as the Complaint does, fails to satisfy Rule

9(b). The Complaint instead must "specify which [of the VR Investors] received which [audit report]." *Moore*, 885 F.2d at 540; *see Farlow v. Peat, Marwick, Mitchell & Co.*, 956 F.2d 982, 988-89 (10th Cir. 1992). It must also "specify when [each VR Investor] was exposed to [the allegedly false statements] [and] which ones [that Investor] found material." *Kearns*, 567 F.3d at 1126. And it must specify the individual investment that the Investor made as a result. *See In re NationsMart Corp. Sec. Litig.*, 130 F.3d 309, 321 (8th Cir. 1997). Without those allegations, it is impossible for Mayer Hoffman to know "the *particular* misconduct" for which any VR Investor seeks to recover. *Bly-Magee*, 236 F.3d at 1019 (emphasis added).

Lastly, VR "failed to specify which [reports] [each VR Investor] *relied upon* in making his decision to [invest in the RevOp Program]." *Kearns*, 567 F.3d at 1126 (emphasis added). This reliance element must be pleaded with particularity. *See NationsMart*, 130 F.3d at 321 ("We agree with the District Court that the plaintiffs failed to plead reliance in accordance with . . . Rule 9(b)."); *Hearn*, 279 F. Supp. 2d at 1114 ("Plaintiffs are also required to allege with particularity . . . reliance on the truth of [the allegedly false] statements."). This element is no mere formality. Indeed, some VR Investors may not even have received the audit reports. *Cf. NationsMart*, 130 F.3d at 321. The Complaint alleges only that "*some or all* of [the VR Investors] were provided some or all of" the "POMs relating to the RevOp Loan Program," which, in turn, allegedly attached the reports. (Compl. ¶ 48 (emphasis added); *see id.* ¶ 76.) Further, the last POM any VR Investor received—one dated July 10, 2006 (*see* Compl. ¶ 76)—was issued well *before* later reports that VR now seeks to use in this suit. (*Id.* ¶ 75.) VR's use of audit reports that post-date any VR Investor's purchases is a classic case of "alleging fraud by hindsight." *Denny v. Barber*, 576 F.2d 465, 470 (2d Cir. 1978) (Friendly, J.). The VR Investors' "[c]onclusory statements of reliance are not sufficient to explain with particularity how [each VR

Investor] detrimentally relied." *Evans v. Pearson Enters., Inc.*, 434 F.3d 839, 852-53 (6th Cir. 2006).

B. These Deficiencies Require The Court To Dismiss Not Only VR's Fraud Count But All Counts That Are Based On The Fraud Allegations.

VR's failure to satisfy Rule 9(b) requires the dismissal of Mayer Hoffman, CBIZ, CBIZ MHM, McLane, and Kramer from not only the fraud count (Count I), but any other counts that are based on those fraud allegations. Where "the plaintiff . . . allege[s] a unified course of fraudulent conduct and rel[ies] entirely on that course of conduct as the basis of a claim," "the claim is said to be 'grounded in fraud,'" even if "fraud is not a necessary element of [the] claim." *Vess*, 317 F.3d at 1103. In those circumstances, "the pleading of that claim as a whole must satisfy . . . Rule 9(b)." *Id.* at 1103-04; *see Borsellino v. Goldman Sachs Group, Inc.*, 477 F.3d 502, 507 (7th Cir. 2007) ("A claim that 'sounds in fraud'—in other words, one that is premised upon a course of fraudulent conduct—can implicate Rule 9(b)'s heightened pleading requirements."); *Cal. Public Employees' Ret. Sys. v. Chubb Corp.*, 394 F.3d 126, 161-62 & n.25 (3d Cir. 2004) (citing cases). Accordingly, not just the fraud count, but the counts alleging aiding and abetting bad faith, aiding and abetting breach of fiduciary duty, and conspiracy also must be dismissed.

Aiding and Abetting Bad Faith. VR's count for aiding and abetting ML's breach of the implied covenant of good faith and fair dealing must be dismissed under Rule 9(b) because it cannot survive without the fraud allegations. (Compl. ¶¶ 122-26.) This covenant "forbids a party to a contract from doing anything denying the right of the other to receive the benefits that flow from the contract." *Burkons v. Ticor Title Ins. Co. of Cal.*, 813 P.2d 710, 720 (Ariz. 1991). Courts have recognized that where the alleged interference with contract rights is rooted in fraud, Rule 9(b) applies to the bad-faith claim. *See UBS Asset Mgmt. (New York) Inc. v. Wood Gundy*

Corp., 914 F. Supp. 66, 71-72 (S.D.N.Y. 1996) (dismissing claims "for breach of an implied covenant of good faith and fair dealing" for failing to comply with Rule 9(b)); *Toner v. Allstate Ins. Co.*, 821 F. Supp. 276, 284-85 (D. Del. 1993) (same). Likewise, a claim alleging aiding and abetting fraud must satisfy Rule 9(b). *See, e.g., Am. United Life Ins. Co. v. Martinez*, 480 F.3d 1043, 1065 (11th Cir. 2007); *Armstrong v. McAlpin*, 699 F.2d 79, 92 (2d Cir. 1983).

Here, as the basis for its bad-faith claim, VR's Complaint alleges within Count IV only that "*[b]y its conduct described above*, [ML] breached its implied covenants of fair dealing and good faith to the" VR Investors. (Compl. ¶ 124 (emphasis added)); *cf. S.E.C. v. Fraser*, No. CV-09-00443-PHX-GMS, 2009 WL 2450508, at *13 (D. Ariz. Aug. 11, 2009) (criticizing "method of pleading" in which the complaint "set forth a lengthy narrative facts section" and then suggested that defendants acted unlawfully "'by engaging in the conduct alleged above'"). There can be no doubt that the "conduct described above" was ML's alleged fraud. (*Id.*) Indeed, the Complaint is replete with those fraud allegations. The very first sentence describes "[t]his action [as being] about the more than $52 million that [the VR Investors] lost as the result of the almost $1 billion *fraud* that [ML]" and the Defendants perpetrated. (Compl. ¶ 1 (emphasis added); *see id.* ¶ 62.) And it claims that ML provided investors "intentionally misleading and false information." (*Id.* ¶ 26.) ML also teamed up with an entity called Radical Bunny, LLC, "to perpetrate [its] fraud on its investors" (*id.* ¶ 44), and engaged in "a classic Ponzi scheme" by "con[ning] new investors" (*id.* ¶ 50; *see id.* ¶ 40). ML's CEO, moreover, made "bald-faced lies" to investors. (*Id.* ¶ 61.) And the so-called "MHM Defendants" are alleged to have "intentionally and willfully acted in concert with" ML "pursuant to a common plan or scheme." (*Id.* ¶ 99.)

These allegations make clear that VR "alleges that [ML] engaged in a fraudulent course of conduct" with the aid of the Defendants. *Kearns*, 567 F.3d at 1126. This fraudulent conduct

is the only basis for VR's allegations that ML violated the implied covenant of good faith and fair dealing (Compl. ¶ 124) or that these Defendants knowingly assisted that breach (*id.* ¶ 125). Since the fraud allegations must be disregarded because they fail to comply with Rule 9(b), VR has nothing left to state a valid claim for aiding and abetting ML's bad faith. These defendants thus must be dismissed from Count IV. *See Vess*, 317 F.3d at 1105.

Aiding and Abetting Breach of Fiduciary Duty. Nearly identical analysis controls VR's claim alleging aiding and abetting breach of fiduciary duty. (*See* Compl. ¶¶ 127-31.) If the breach of fiduciary duty arises out of fraud, Rule 9(b) applies. *See Borsellino*, 477 F.3d at 507; *Litson-Gruenber v. JPMorgan Chase & Co.*, No. 7:09-CV-056-0, 2009 WL 4884426, at *4 (N.D. Tex. Dec. 16, 2009) (noting that where plaintiff alleged defendant breached fiduciary duties by participating in Ponzi scheme, "[p]laintiff's claims [were] premised on allegations of fraud and . . . subject to . . . Rule 9(b)"). The same rule applies to allegations that a defendant aided and abetted the breach of a fiduciary duty. *See Kolbeck v. LIT America, Inc.*, 939 F. Supp. 240, 245 (S.D.N.Y. 1996) ("To the extent the underlying [breaches of fiduciary duty] are based on fraud, the allegations of aiding and abetting liability must meet" Rule 9(b).), *aff'd*, 152 F.3d 918 (2d Cir. 1998) (Table).

Here, VR alleges that ML violated its fiduciary "duties of disclosure, loyalty, good faith and fairness" by breaching its "agreements and duties of good faith and fair dealing and by committing the fraudulent and unlawful acts described herein," and that Defendants aided and abetted those breaches. (Compl. ¶¶ 128-29.) At bottom, this allegation seeks to hold Defendants liable for ML's fraud. As described above, VR alleges that ML violated its duties of good faith and fair dealing by committing *fraud*. In addition, if VR sought to rely on a breach of contract rather than a tort for this claim, it could not proceed. A party cannot aid and abet a breach of

contract. *See infra* Section IV.B. As such, VR *must* rely on the fraud allegations. Since it has not pleaded them with particularity against Mayer Hoffman, CBIZ, CBIZ MHM, McLane, and Kramer, this claim must be dismissed against them, as well.

Conspiracy. Conspiracy "requires that two or more individuals agree and thereupon accomplish an underlying tort which the alleged conspirators agreed to commit." *Wells Fargo Bank v. Ariz. Laborers, Teamsters and Cement Masons Local No. 395 Pension Trust Fund*, 38 P.3d 12, 36 (Ariz. 2002) (internal quotation marks omitted). A conspiracy count must satisfy Rule 9(b) when fraud constitutes the tortious objective. *Vess*, 317 F.3d at 1106-07; *see Swartz*, 476 F.3d at 765. Not only that, "[a] plaintiff must allege with sufficient factual particularity that defendants reached some . . . understanding or agreement." *Cervantes*, 2009 WL 3157160, at *9; *see Vess*, 317 F.3d at 1106 (dismissing conspiracy count because plaintiff did "not provide the particulars of when, where, or how the alleged conspiracy occurred"); *Doyle v. Hasbro, Inc.*, 103 F.3d 186, 194 (1st Cir. 1996) (agreeing with "district court that the allegations of conspiracy . . . [were] insufficient to satisfy the requirements of Rule 9(b)").

Here, Rule 9(b) applies to VR's conspiracy count because that count depends on VR's fraud claims. (*See* Compl. ¶¶ 132-35.) In fact, it specifically alleges that the "MHM Defendants" "conspired . . . to commit all or some of the *fraudulent*, unlawful and wrongful acts." (*Id.* ¶ 133 (emphasis added).) VR's conspiracy count, therefore, "sound[s] in fraud" and the count "as a whole must satisfy the particularity requirement of Rule 9(b)." *Kearns*, 567 F.3d at 1125 (internal quotation marks omitted). It does not. In addition to its failure to plead fraud with particularity, the Complaint also provides no allegations detailing the conspiracy's scope. VR has "not stated how or even when the alleged conspiracy was formed." *Cervantes*, 2009 WL

3157160, at *9. Nor has it provided any motive for Mayer Hoffman or the other Defendants to enter the conspiracy. *See DiLeo*, 901 F.2d at 629.

Indeed, the conspiracy allegations are just as conclusory as those rejected in *Twombly* under the more lenient Rule 8 standard. There, the plaintiffs alleged that telephone companies had entered into a conspiracy to divide up the national market for telephone services, relying upon the companies' "parallel conduct" of refusing to enter each other's markets. 550 U.S. at 550-51. But parallel conduct is insufficient as a matter of law to prove prohibited intent. Thus, the Court held that combining factual allegations of parallel conduct with conclusory assertions of conspiracy did not raise a "plausible suggestion of conspiracy," as required by Rule 8. *Id.* at 566. In this case, the Complaint alleges, at best, that Mayer Hoffman committed accounting errors. (Compl. ¶¶ 78-82, 87-91.) But accounting errors are insufficient as a matter of law to prove prohibited intent (*i.e.*, scienter). *See Software*, 50 F.3d at 627. Thus, as in *Twombly*, combining factual allegations of accounting errors with conclusory assertions of conspiracy does not plausibly suggest conspiracy. 550 U.S. at 566. The conspiracy count, therefore, fails to satisfy *Rule 8*, much less the more demanding *Rule 9(b)* standard. It must be dismissed with respect to Mayer Hoffman, CBIZ, CBIZ MHM, McLane, and Kramer.

* * *

In sum, the Complaint is a textbook violation of Rule 9(b). It lumps together Defendants, asserts conclusory allegations of fraud, and fails to allege the statements on which each individual VR Investor relied. These failings defeat not only the fraud claim, but also the claims alleging aiding and abetting bad faith, aiding and abetting breach of fiduciary duty, and conspiracy.

II. EVEN APART FROM RULE 9(B), VR CANNOT STATE A VALID FRAUD CLAIM AGAINST ANY OF THESE DEFENDANTS.

Setting aside its violations of Rule 9(b), the fraud count still must be dismissed against the so-called MHM Defendants. While styled as a single count, Count I seeks liability under common law, aiding-and-abetting, and statutory fraud theories. (Compl. ¶¶ 104-05.) All of these claims fail because VR's allegations do not plausibly establish that Mayer Hoffman, CBIZ, CBIZ MHM, McLane, and Kramer acted with the requisite fraudulent scienter. *See infra* Section II.A. In addition, its claim under A.R.S. § 13-2310 cannot proceed because that provision does not permit a civil action, *see infra* Section II.B, and its consumer-fraud claim fails because the statute of limitations has run, *see infra* Section II.C.

A. VR's Fraud Count Does Not Plausibly Show That Mayer Hoffman, CBIZ, CBIZ MHM, McLane, And Kramer Acted With The Requisite Scienter.

Any fraud claim against the so-called MHM Defendants must be dismissed because VR's allegations do not set forth "plausible grounds" that they knowingly participated in a fraud on the VR Investors. *Twombly*, 550 U.S. at 556. While Rule 9(b) indicates that state of mind "may be alleged generally," the Court "must not mistake the relaxation of Rule 9(b)'s specificity requirement regarding condition of mind for a license to base claims of fraud on speculation and conclusory allegations." *Chill v. Gen. Elec. Co.*, 101 F.3d 263, 267 (2d Cir. 1996) (internal quotation mark omitted). Accordingly, to overcome a motion to dismiss, the Complaint "must afford a basis for believing that [VR] could prove [this] scienter" requirement. *DiLeo*, 901 F.2d at 629; *see Melder*, 27 F.3d at 1102 ("The plaintiffs must set forth *specific facts* supporting an inference of fraud."). The Supreme Court's *Twombly* and *Iqbal* decisions confirm that this case law from the courts of appeals sets forth the proper standard for pleading state of mind. *Iqbal*, 129 S. Ct. at 1949-50; *Twombly*, 550 U.S. at 555-56.

VR's fraud claim falls short. The Complaint repeatedly resorts to conclusory allegations that must be disregarded. (*See* Compl. ¶¶ 26, 28, 37-39, 58, 61, 72, 74, 78, 81, 84, 95, 98-99.) It alleges, for example, that these Defendants "knew at the time that [Mayer Hoffman's reports] were false . . . ." (*Id.* ¶ 78.) Nevertheless, "[a]ssertions that [they] had knowledge that the [reports] [were] false . . . are nothing more than rote conclusions." *Robin*, 915 F.2d at 1127. Similarly, VR alleges in entirely conclusory terms that these Defendants consented to investors receiving the reports. (Compl. ¶ 95); *see supra* Section III.A; *Iqbal*, 129 S. Ct. at 1949.

Disregarding those allegations leaves VR with, at best, claims that Mayer Hoffman conducted audits and issued reports that violated GAAP and GAAS. (Compl. ¶¶ 78-92.) The reports, for example, did not "consolidate statements of the LLCs through which [ML] securitized . . . its loan participations" as GAAP allegedly required (*id.* ¶ 87), or "include[] GAAP-required 'going-concern' qualifications" (*id.* ¶ 89). As a matter of law, however, "the mere publication of inaccurate accounting figures, or a failure to follow GAAP, without more, does not establish scienter." *Software*, 50 F.3d at 627; *see also Chill*, 101 F.3d at 270 ("Allegations of a violation of GAAP provisions or SEC regulations, without corresponding fraudulent intent, are not sufficient to state a securities fraud claim."); *Melder*, 27 F.3d at 1103 ("The plaintiffs' boilerplate averments that the accountants violated particular accounting standards are not, without more, sufficient to support inferences of fraud."). And *Twombly* held that, without more, alleging facts that would be insufficient as a matter of law to prove an element—in *Twombly*, facts showing parallel conduct, and, here, facts showing accounting errors—is also insufficient to survive a motion to dismiss. 550 U.S. at 566.

Nor has VR alleged anything "more" than these accounting errors. *Software*, 50 F.3d at 627. Most notably, it has not asserted facts suggesting that "the fraud (or cover-up) was in the

interest of" Mayer Hoffman, CBIZ, CBIZ MHM, McLane, or Kramer. *Robin*, 915 F.2d at 1127 (internal quotation marks omitted). Without any explanation *why* they would "[have] thrown in [their] lot with the primary violators," *DiLeo*, 901 F.2d at 629 (internal quotation marks omitted), VR's Complaint is insufficient. Indeed, courts have repeatedly recognized that "a large independent accountant will rarely, if ever, have any rational economic incentive to participate in its client's fraud." *Reiger v. Price Waterhouse Coopers LLP*, 117 F. Supp. 2d 1003, 1007 (S.D. Cal. 2000), *aff'd sub nom.*, *DSAM Global Value Fund v. Altris Software, Inc.*, 288 F.3d 385 (9th Cir. 2002). Here, for example, "[f]ees for [several] years' audits could not approach the losses [Mayer Hoffman] would suffer from a perception that it would muffle a client's fraud." *DiLeo*, 901 F.2d at 629. VR, therefore, has alleged nothing to suggest that Mayer Hoffman or the others were "willing to put [their] professional reputation on the line by conducting fraudulent auditing work for [ML]." *Melder*, 27 F.3d at 1103.

Nor has VR alleged any factual basis for concluding that these Defendants *knew* of the specific misrepresentations alleged to be in the financial statements. *See Greenstone v. Cambex Corp.*, 975 F.2d 22, 25 (1st Cir. 1992) (Breyer, J.) ("The courts have uniformly held inadequate a complaint's general averment of the defendant's 'knowledge' . . . , unless the complaint *also* sets forth specific facts that make it reasonable to believe that defendant knew that a statement was materially false."). With respect to the 2004 and 2005 financial statements, for example, the Complaint asserts that Mayer Hoffman falsely stated that ML's "'[m]anagement considers accounts receivable . . . to be collectible in full'" and "'does not believe impairment indicators [for ML's assets] are present.'" (Compl. ¶¶ 79(c)-(d), 81(c)-(d).) Yet the Complaint alleges no facts that would indicate that Mayer Hoffman knew that ML's management did not believe these things. (*See id.* ¶ 76.) As another example, the Complaint provides no basis to plausibly

conclude that Mayer Hoffman knew that the securities offerings of a third party—Radical Bunny (a lender to ML)—violated securities laws. (*Id.* ¶¶ 79(g), 81(f).) Indeed, it does not even allege that Mayer Hoffman had discussions with ML or Radical Bunny about those offerings.

Finally, the manner in which VR couches its accusations confirms the lack of any specific evidence plausibly establishing fraud. For the most part, VR sets forth *negligence* terminology, suggesting that the so-called MHM Defendants "knew or *should have known*" about the misstatements. (*See, e.g.*, Compl. ¶¶ 37-39, 58, 84 (emphasis added).) But "claims that [they] should have known that the [financial statements] [were] false and misleading also fail to allege scienter." *Robin*, 915 F.2d at 1127. VR's resort to negligence allegations only confirms that VR's well-pleaded facts do not establish "plausible grounds" that these Defendants knowingly defrauded the VR Investors. *Twombly*, 550 U.S. at 556.

B. VR Cannot State A Fraud Claim Under A.R.S. § 13-2310.

In addition to the fraud count's other failures, the Court should dismiss any fraud claim under A.R.S. § 13-2310 because that provision does not authorize civil suits. (Compl. ¶ 105.) It provides: "Any person who, pursuant to a scheme or artifice to defraud, knowingly obtains any benefit by means of false or fraudulent pretenses, representations, promises or material omissions is guilty of a class 2 felony." A.R.S. § 13-2310(A). Nowhere does it explicitly permit a civil action. Nor would Arizona courts infer an implied action. Enacted in 1976, the "statute was adapted from the federal mail fraud statute." *Haas*, 675 P.2d at 678. "Courts have consistently found that the [federal] mail and wire fraud statutes do not confer private rights of action." *Ateser*, 1994 WL 377872, at *2. Because that view pre-dates Arizona's adoption of the federal law, *see, e.g.*, *Napper v. Anderson, Henley, Shields, Bradford & Pritchard*, 500 F.2d 634, 636 (5th Cir. 1974), these federal decisions are "persuasive" for interpreting § 13-2310(A). *Haas*,

675 P.2d at 678 (internal quotation marks omitted). Since no cause of action exists under federal law, § 13-2310 excludes one as well.

C. The Applicable Statute Of Limitations Bars Any Consumer Fraud Claim.

Any potential fraud count under the Arizona Consumer Fraud Act, A.R.S. § 44-1522, falls outside the applicable statute of limitations. (Compl. ¶ 105.) "Actions commenced pursuant to A.R.S. § 44-1522 must be brought within one year." *Cervantes*, 2009 WL 3157160, at *7 (granting motion to dismiss consumer-fraud claim); *see* A.R.S. § 12-541(5). In addition, "[a]n action accrues under [§ 44-1522] 'when the defrauded party discovers or with reasonable diligence could have discovered the fraud'"—that is, "when 'the plaintiff knows or should have known of both the *what* and *who* elements of causation.'" *Cervantes*, 2009 WL 3157160, at *7 (quoting *Alaface v. Nat'l Inv. Co.*, 892 P.2d 1375, 1379 (Ariz. Ct. App. 1994)).

Measured by these standards, VR's consumer-fraud claim is time-barred. The VR Investors did not enter into a tolling agreement with Mayer Hoffman until December 2009. (Compl. ¶ 18.) Thus their claim is untimely unless they could not have discovered it until after *December 2008*.

The Complaint makes clear, however, that the VR Investors knew or, as a matter of law, should have known of the alleged consumer fraud well *before* December 2008—indeed, no later than *June 2008*, when the alleged Ponzi scheme "came crashing down," "forc[ing] [ML] into bankruptcy." (Compl. ¶ 42.) By that time, the VR Investors knew the "what" and "who" of the alleged consumer fraud. *Cervantes*, 2009 WL 3157160, at *7. As for the "who," the Complaint suggests that some or all of the VR Investors received Mayer Hoffman's audit reports dating back to 2006 and earlier (*see* Compl. ¶¶ 75-76), establishing that the Investors knew who conducted ML's auditing services well before June 2008.

As for the "what," they knew or should have known of the alleged misrepresentations when ML collapsed and stopped making interest payments or redemptions. (*See id.* ¶ 42.) Indeed, the Complaint indicates that the VR Investors had actual knowledge of the fraud by mid-2007. At that time, they refused to accept ML's offer to transfer their interests in the RevOp Loan Program into other programs because, as VR puts it, "*fool me once, shame on you; fool me twice shame on me*!" (*Id.* ¶ 40.)

Even without the Complaint's concessions that the VR Investors knew of the alleged fraud well before December 2008, it would be clear that they should have known. Indeed, news articles printed before that date made reference to the Ponzi scheme VR alleges here.[1] And similar allegations were made in judicial documents in ML's bankruptcy. (*See* Doc. 267, Emergency Motion for an Order Converting the Case to a Chapter 7 Proceeding, at 16-17.)

Finally, the VR Investors "did not have to know all of the underlying details of the misrepresentation before their cause of action accrued." *Alaface*, 892 P.2d at 1379. Rather, the statute began to run when they had "grounds for suspecting a fraud." *Coronado Dev. Corp. v. Superior Court of Ariz.*, 678 P.2d 535, 537 (Ariz. Ct. App. 1984). Since they had those grounds by June 2008, any consumer fraud claim is untimely.

III. VR CANNOT BRING A NEGLIGENT MISREPRESENTATION CLAIM BASED ON MAYER HOFFMAN'S AUDIT REPORTS.

Count II, a negligence claim, cannot stand. Like many States, Arizona adopted Restatement (Second) of Torts § 552 to govern negligent misrepresentation. *Van Buren v. Pima*

---

[1] *See, e.g.*, Jan Bucholz, *Rightpath pushes to convert Mortgages Ltd. Chapter 11 reorganization to Chapter 7 liquidation*, Business Journal (Phoenix) (Aug. 4, 2008) ("Rightpath continues to assert that Mortgages Ltd. was involved in a Ponzi scheme . . . .") (attached as Ex. A); John Blakeley, *Radical Bunny hits Ch. 7 hole*, Daily Deal (Oct. 13, 2008) (noting that "[s]everal investors have since alleged [ML] operated a Ponzi scheme") (attached as Ex. B); *see also Heliotrope Gen., Inc. v. Ford Motor Co.*, 189 F.3d 971, 981 n.18 (9th Cir. 1999) (taking "judicial notice" of "news articles" for motion for judgment on the pleadings).

Cmty. Coll. Dist. Bd., 546 P.2d 821, 823 (Ariz. 1976). As a result, if a plaintiff fails to meet § 552's requirements, it cannot bring a "negligence" claim outside of § 552. *See Standard Chartered PLC v. Price Waterhouse*, 945 P.2d 317, 341-42 (Ariz. Ct. App. 1997). Section 552 requires, among other things, that (1) the defendant "suppl[y] false information"; (2) that the plaintiff fall within the "limited group of persons" to which the defendant owes a duty when supplying that information and (3) that the plaintiff "justifiabl[y] rel[y]" on the defendant's representations. Restatement (Second) of Torts § 552(1), (2)(a). VR cannot satisfy these elements.

A. As A Matter Of Law, Mayer Hoffman's Annual Audits Did Not Create A Duty Of Care To The VR Investors.

VR cannot bring a negligent misrepresentation claim based upon Mayer Hoffman's annual audits because the Complaint cannot establish that ML requested those audits for the *specific* purpose of providing assurances to VR Investors as opposed to *general* corporate purposes.

Restatement (Second) of Torts § 552 imposes "deliberatively restrictive" liability "to encourage the free flow of commercial information." *Ellis v. Grant Thorton LLP*, 530 F.3d 280, 289 (4th Cir. 2008). To recover, "the plaintiff [must fall] within the limited class of persons to whom the defendant owes a duty." *Flagstaff Affordable Hous. Ltd. P'ship v. Design Alliance, Inc.*, 223 P.3d 664, 672 (Ariz. 2010). A defendant that supplies information to another does not owe a duty to *all* third parties that the defendant knows "'might reasonably be expected sooner or later to have access to the information and foreseeably to take some action in reliance upon on it.'" *Kuehn v. Stanley*, 91 P.3d 346, 350 (Ariz. Ct. App. 2004) (quoting Restatement (Second) of Torts § 552 cmt. h). Rather, the defendant's duty flows only to third parties in "the limited group

of persons for whose benefit and guidance [the defendant] . . . knows that the recipient intends to supply" the information. Restatement (Second) of Torts § 552(2)(a).

Applying this dichotomy to accountants, "an auditor retained to conduct an annual audit and to furnish an opinion for no particular purpose generally undertakes no duty to third parties." *Bily*, 834 P.2d at 768 (adopting § 552). That is the case even though the auditor knows "[its audit reports] may be relied upon by lenders, investors, shareholders, creditors, purchasers and the like." Restatement (Second) of Torts § 552, illus. 10. For an auditor to face liability to a specific investor, therefore, the investor must show not simply that the auditor knows that investors may uses its audit reports but also that the investor was the "*specifically intended* beneficiar[y] of [the] reports." *Gillespie v. Schneider*, No. 94-55995, 1996 WL 111593, at *2 (9th Cir. Mar. 13, 1996) (emphasis added) (internal quotation marks omitted); *Glenn K. Jackson, Inc. v. Roe*, 273 F.3d 1192, 1200 n.3 (9th Cir. 2001) (noting that "in order to recover under a theory of negligent misrepresentation, the plaintiff must be an intended beneficiary"). To make that determination, § 552 "creates *an objective standard* that looks to the specific circumstances (*e.g.*, supplier-client engagement and the supplier's communications with the [group of investors])." *Bily*, 834 P.2d at 769.

Here, VR alleges that Mayer Hoffman negligently conducted its audits of ML. (Compl. ¶¶ 78-82, 87-91.) But VR cannot show that the VR Investors were specifically intended beneficiaries of Mayer Hoffman's audits. Indeed, the Complaint concedes that Mayer Hoffman served as ML's general auditor for a decade, providing *annual* audits of ML's financial statements for corporate purposes. (*Id.* ¶¶ 8, 75); *see Bily*, 834 P.2d at 768. And VR makes no assertion that the engagement letters between ML and Mayer Hoffman acknowledged the VR Investors' use of the reports. *See id.* at 769 (analyzing "supplier-client engagement"). Nor does

VR make any claim that the VR Investors communicated with Mayer Hoffman about its audits. *See id.* (analyzing "supplier's communications with third party"). Finally, VR does not cite a single meeting, letter, or conversation in which ML told Mayer Hoffman that it needed the audit reports to provide assurances to a limited group of identifiable investors or creditors. The Complaint, therefore, provides no "plausible grounds" to prove that the VR Investors were intended beneficiaries of Mayer Hoffman's audit reports. *Twombly*, 550 U.S. at 556.

Instead, the Complaint attempts to satisfy this "duty" element through *conclusory* assertions that Mayer Hoffman knew that ML would use its reports to attract the VR investors. It claims, for example, that "[w]ith the MHM Defendants' . . . *knowledge and consent*, [ML's] representatives . . . used the . . . false or misleading auditors' reports and financial statements to recommend investments in [the RevOp Program]." (Compl. ¶ 95 (emphasis added); *see id.* ¶ 112.) But the Court must disregard these conclusory allegations as they "are not entitled to the assumption of truth." *Iqbal*, 129 S. Ct. at 1951. Indeed, VR's allegations concerning Mayer Hoffman's knowledge and consent are *identical* to allegations rejected in *Iqbal*. There, the complaint alleged that the defendants "'knew of'" and "'agreed to'" the plaintiff's "'conditions of confinement.'" *Id.* The Court refused to accept these assertions to satisfy the scienter element. *Id.* That decision controls here.

That leaves VR with the allegation that "[a]ccording to the SEC, the MHM Defendants knew that the primary reason for its audits was to provide independent assurances of [ML's] financial stability and accuracy of its financial statements to its investors." (Compl. ¶ 74.) But this allegation does not suffice. For one thing, it is itself entirely conclusory. The only SEC findings of which Defendants are aware—the ones incorporated by reference into VR's Complaint (*see id.* ¶ 46 n.3)—nowhere refer to Mayer Hoffman, CBIZ, CBIZ MHM, McLane, or

Kramer. *See In re Mortgages, Ltd. Sec. LLC*, Release No. 61377 (Jan. 19, 2010). Indeed, those findings suggest that investors received audited financial statements *only* for fiscal years 2005 and 2006, and state nothing as to whether any of these Defendants knew that fact. *Id.* ¶ 7. For another, this allegation refers to *all* investors, not simply the investors in the RevOp Program. As several courts recognize, "[t]o interpret the 'limited group' requirement" in § 552 "as including *all potential investors* would render that requirement meaningless." *Scottish Heritable Trust, PLC v. Peat Marwick Main & Co.*, 81 F.3d 606, 613 (5th Cir. 1996) (emphasis added); *see Grant Thornton LLP v. Prospect High Income Fund*, No. 06-0975, 2010 WL 2636124, at *6 (Tex. Jul. 02, 2010). But that is exactly what the VR Investors improperly seek to do here.

This case, therefore, falls squarely within Illustration 10 to § 552, which explains that an accountant's "annual audit of the customary scope" (like the annual audits that Mayer Hoffman performed) does not establish the accountant's duty to foreseeable creditors or investors who may receive and rely on the audit report (like the VR Investors are alleged to be). Even though the auditor "knows that the financial statements, accompanied by an auditor's opinion, are customarily used in a wide variety of financial transactions by the corporation and that they may be relied upon by lenders, investors, shareholders, creditors, purchasers and the like, in numerous possible kinds of transactions," the auditor "is not liable." Restatement (Second) of Torts § 552, illus. 10; *see Hoffman v. Greenberg*, 767 P.2d 725, 727-28 (Ariz. Ct. App. 1988). Because VR has not alleged facts plausibly establishing that the VR Investors were specifically intended beneficiaries of Mayer Hoffman's audit reports, their negligent misrepresentation claim fails.

B. VR Fails To Allege That Any Specific VR Investor Reasonably Relied On The Alleged Misstatements By Mayer Hoffman.

VR also has failed to allege that the VR Investors justifiably relied upon Mayer Hoffman's audit reports when making investment decisions. A plaintiff "must show 'justifiable

reliance' to prevail on a claim for negligent misrepresentation." *Kuehn*, 91 P.3d at 350. "As the words of the phrase imply, *justifiable reliance* comprises two elements: (1) the plaintiff must in fact rely on the information; and (2) the reliance must be reasonable." *Scottish Heritable*, 81 F.3d at 615. A failure to adequately plead this element requires dismissal. *See Linder v. Brown & Herrick*, 943 P.2d 758, 765 (Ariz. Ct. App. 1997) (granting dismissal because plaintiffs "failed to allege that they justifiably relied on any statements made by" defendants).

Here, VR has not pleaded facts plausibly establishing that the VR investors relied on any false statement by Mayer Hoffman, CBIZ, CBIZ MHM, McLane, or Kramer. *Twombly*, 550 U.S. at 555. Indeed, VR has not pleaded facts plausibly establishing that any *particular* VR Investor relied on any *particular* statement by those Defendants for any *particular* investment decision, let alone that *all* eighteen VR Investors relied on statements by *all* the Defendants for *all* their investments. Instead, VR alleges generally that Mayer Hoffman's audit reports were "reasonably relied upon by [the VR investors] for their RevOp investment decisions and transactions." (Compl. ¶¶ 112-13.) But this "[t]hreadbare recital[] of the [reliance] element[]" does "not suffice." *Iqbal*, 129 S. Ct. at 1949; *Hunt v. U.S. Tobacco Co.*, 538 F.3d 217, 227 (3d Cir. 2008).

As for specific allegations, the Complaint alleges, at best, only that "some or all of [the VR Investors]" received POMs that attached Mayer Hoffman's audit reports. (Compl. ¶¶ 48, 76.) It does not identify any false statements by CBIZ, CBIZ MHM, McLane, or Kramer. And it does not identify the specific VR investor that received the referenced POMs. Finally, it specifically identifies only *one* POM that allegedly attached the audit reports, the one dated July 10, 2006. (*Id.* ¶ 76.) But VR alleges that this July 2006 POM was the "most recent" one that the VR investors received, suggesting that the VR investors received no other POMs (and audit reports) after that date. (*Id.*) The failure of VR to allege what information each VR investor

received and considered from any of these Defendants dooms the VR's claim. *See Kaufman v. i-Stat Corp.*, 754 A.2d 1188, 1195 (N.J. 2000) ("The actual receipt and consideration of any misstatement remains central to the case of any plaintiff seeking to prove that he or she was deceived by the misstatement or omission.").

Indeed, VR's *conclusory* allegations are especially unacceptable for the reliance element. That element is gauged by "an *individual standard* of the plaintiff's own capacity and . . . knowledge." W. Page Keeton, Prosser & Keeton on Torts § 108, at 751 (5th ed. 1984) (emphasis added); *cf. McLaughlin v. Am. Tobacco Co.*, 522 F.3d 215, 223 (2d Cir. 2008) (noting that "proof of [a] misrepresentation—even widespread and uniform misrepresentation—only satisfies half of the equation; the other half, reliance on the misrepresentation, cannot be the subject of general proof"); *Broussard v. Meineke Discount Muffler Shops, Inc.*, 155 F.3d 331, 341 (4th Cir. 1998) (noting that "the reliance element of plaintiffs' fraud and negligent misrepresentation claims [was] not readily susceptible to class-wide proof" as "proof of reasonable reliance . . . depend[ed] upon a fact-intensive inquiry into what information each [plaintiff] actually had"). As such, the plausibility of VR's allegations must be determined on an investor-by-investor basis. Otherwise, VR would receive preferential treatment solely because it obtained assignments of unique claims and joined them in one lawsuit. The Court should not countenance that result. The Complaint fails to establish any grounds, much less "plausible grounds," that any VR Investor relied on statements by CBIZ, CBIZ MHM, McLane or Kramer when making investment decisions. *Twombly*, 550 U.S. at 556.

C. The Complaint Fails To Allege That CBIZ, CBIZ MHM, McLane, Or Kramer Supplied Any Information To ML Or The VR Investors, Let Alone False Information.

At the least, the Court must dismiss CBIZ, CBIZ MHM, McLane, and Kramer from this count. According to the Complaint, the alleged negligent misrepresentations were contained

within "*[Mayer Hoffman]*'s" various "Independent Auditors' Report[s]." (Compl. ¶ 75 (emphasis added).) Any information, therefore, was supplied by—and attributable to—Mayer Hoffman. Other than conclusory allegations, the Complaint does not allege any basis for attributing Mayer Hoffman's audit reports to CBIZ, CBIZ MHM, McLane, or Kramer. Those Defendants, therefore, did not supply any information to ML or its investors, and cannot be liable under § 552. *See Richey v. Patrick*, 904 P.2d 798, 802 (Wyo. 1995) (rejecting negligent misrepresentation claim where the defendant "did not supply any information to the [plaintiffs]" because "since nothing has been represented, an essential element of the claim is missing"); *cf. Pacific Inv. Mgmt. Co. LLC v. Mayer Brown LLP*, 603 F.3d 144, 155 (2d Cir. 2010) (holding that "secondary actors can be liable [under federal securities law] for only those statements that are *explicitly attributed* to them) (emphasis added).

IV. VR'S AIDING-AND-ABETTING COUNTS CANNOT STAND FOR A HOST OF REASONS IN ADDITION TO THEIR FAILURE TO SATISFY RULE 9(B).

The Court should dismiss Mayer Hoffman, CBIZ, CBIZ MHM, McLane, and Kramer from all of VR's aiding-and-abetting claims because VR has not alleged facts that plausibly establish that these Defendants *knowingly* assisted ML's unlawful conduct. The claims alleging aiding and abetting breach of contract and bad faith fail for the additional reason that no cause of action for aiding and abetting, which is rooted in *tort* law, exists for *contract* claims.

A. VR Has Not Plausibly Established The Scienter Necessary To Support Its Aiding-And-Abetting Claims Against Mayer Hoffman, CBIZ, CBIZ MHM, McLane, And Kramer.

Any aiding-and-abetting claim against Mayer Hoffman, CBIZ, CBIZ MHM, McLane, and Kramer must be dismissed because VR has not alleged "plausible grounds" that these Defendants aided and abetted ML's unlawful conduct. *Twombly*, 550 U.S. at 556. "To state a claim for aiding and abetting," VR must establish that "[these Defendants] knew [ML's] conduct

constituted a tort," and that "[they] substantially assisted or encouraged [ML] in the achievement of the tort." *Stern*, 2010 WL 1250732, at *8 (citing *Wells Fargo Bank*, 38 P.3d at 23).

Here, for the same reasons that VR has not established the scienter necessary for fraud, it has fallen short in "afford[ing] a basis for believing that [VR] could prove [aiding-and-abetting's] scienter" with respect to Mayer Hoffman, CBIZ, CBIZ MHM, McLane, and Kramer. *DiLeo*, 901 F.2d at 629. For the most part, it asserts conclusory allegations that they acted with the requisite knowledge, allegations not entitled to the presumption of truth. *Robin*, 915 F.2d at 1127. And its specific allegations suggest, at best, that they negligently issued mistaken audits and violated accounting rules. *Software*, 50 F.3d at 627. VR alleges no facts suggesting that they had a motive to assist ML's torts. *DiLeo*, 901 F.2d at 629; *Farlow*, 956 F.2d at 989. And it has not "set[] forth specific facts that make it reasonable to believe that [they] knew that [ML had committed those torts]." *Greenstone*, 975 F.2d at 25. Without plausible grounds that these Defendants knowingly assisted ML's torts, no aiding-and-abetting count can proceed.

B. No Cause Of Action Exists For Aiding And Abetting Breach Of Contract.

VR's count for aiding and abetting breach of contract also must be dismissed because there is no such thing. (*See* Compl. ¶¶ 116-21.) Arizona courts have never recognized that claim. Nor would they. "In Arizona, . . . aiding and abetting [is a] derivative tort[] for which a plaintiff may recover only if it has adequately pled an *independent primary tort*." *AGA*, 589 F. Supp. 2d at 1191-92 (emphasis added); *see Wells Fargo*, 38 P.3d at 23. But "[b]reach of contract is not a tort." *Law Corp. of Brian Finander, P.C. v. Alexander*, No. 1 CA-CV 08-0290, 2009 WL 449233, at *4 (Ariz. Ct. App. Feb. 24, 2009). Accordingly, one cannot aid and abet a breach of contract. *Covington*, 2007 WL 3208579, at *3 (holding that "aiding and abetting tortious conduct cannot be rooted in breach of contract, which is not tortious conduct"); *see Montgomery v. Aetna Plywood Inc.*, 231 F.3d 399, 413 n.6 (7th Cir. 2000).

C. VR's Claim For Aiding And Abetting Bad Faith Cannot Survive Because The VR Investors Contracted With ML To Make Money.

VR's fourth count for aiding and abetting ML's breach of the implied covenant of good faith and fair dealing fails for much the same reasons. (*See* Compl. ¶¶ 122-26.) "[T]he covenant of good faith and fair dealing is legally implied in every contract." *Burkons*, 813 P.2d at 720. As such, "the remedy for breach of the implied covenant . . . is ordinarily *on the contract itself*." *Rawlings*, 726 P.2d at 574 (emphasis added). As discussed, VR cannot assert a contract claim alleging aiding and abetting breach of this implied covenant because aiding and abetting requires an "independent primary tort." *AGA*, 589 F. Supp. 2d at 1191-92. VR, therefore, must show that this is one of the rare cases where tort remedies are available for breach. It has not done so.

As a matter of law, ML's alleged breach of this covenant cannot qualify as tortious. Tort recovery for such a breach, although "well established in actions brought on insurance contracts," is "only reluctantly extended to other relationships." *Rawlings*, 726 P.2d at 574. A tort action based on the covenant requires the plaintiff to prove "a special relationship between the parties arising from elements of public interest, adhesion, and fiduciary responsibility." *Burkons*, 813 P.2d at 720. "[T]he two most important factors in determining whether a tort action for bad faith will lie are (1) whether the plaintiff contracted for security or protection rather than for profit or commercial advantage, and (2) whether permitting tort damages will provide a substantial deterrence against breach by the party who derives a commercial benefit from the relationship." *Beaudry*, 50 P.3d at 842 (internal quotation marks omitted); *see Trs. of Capital Wholesale Elec. Co. Profit Sharing & Trust Fund v. Shearson Lehman Bros., Inc.*, 270 Cal. Rptr. 566, 569-71 (Cal. Ct. App. 1990).

These factors show that only a subset of fiduciary-like relationships satisfy this special-relationship test. "The paradigm example is an insurance contract in which the insured is

contracting primarily for security," and the insurer has an incentive to refuse to pay claims if the insured were limited to contract remedies. *Sutter Home Winery, Inc. v. Vintage Selections, Ltd.*, 971 F.2d 401, 408 (9th Cir. 1992). Relationships not exhibiting similar characteristics do not meet the test. For example, while an escrow agent owes fiduciary duties to clients, *Burkons*, 813 P.2d at 355, the Arizona Supreme Court has rejected a client's bad-faith tort claim against an escrow agent, *id.* at 355-56. Nor can an employee sue an employer in tort under this covenant. *See Wagenseller v. Scottsdale Mem'l Hosp.*, 710 P.2d 1025, 1039-41 (Ariz. 1985), *superseded by statute as stated in, Chaboya v. Am. Nat'l Red Cross*, 72 F. Supp. 2d 1081, 1092 (D. Ariz. 1999); *Foley v. Interactive Data Corp.*, 765 P.2d 373, 393-96 (Cal. 1988). And, perhaps most analogous, under California law—which the Arizona Supreme Court has followed, *see Rawlings*, 726 P.2d at 574-76—clients may not sue their stock brokers in tort for breach of the implied covenant. *See Shearson*, 270 Cal. Rptr. at 569-71.

Turning to this case, "[t]he two most important factors in determining whether a tort action for bad faith will lie" both illustrate that it should not here. *Beaudry*, 50 P.3d at 842 (internal quotation mark omitted). *First*, the VR Investors' "motivation for opening the [RevOp Program] account[s] could only have been to profit, so [VR] [cannot] allege[] the necessary nonprofit motivation" for entering the contracts with ML. *Shearson*, 270 Cal. Rptr. at 570. Unlike in the insurance context where insureds purchase insurance for peace of mind, *Sutter Home*, 971 F.2d at 408, the VR Investors invested to make money. They were sophisticated parties, investing anywhere from $75,000 to $6,907,963.58 (Compl. ¶ 5) and qualifying as "accredited investors" under the securities law's registration exemptions (*id.* Ex. 3 at 2). *See* 17 C.F.R. § 230.501(a); *see also Sutter Home*, 971 F.2d at 408. As such, no tort claim may be

asserted here because the VR Investors contracted "for profit or commercial advantage" rather than security. *Beaudry*, 50 P.3d at 842.

Second, "[t]here is . . . no reason to believe that restricting . . . recovery . . . to contract damages would encourage" the routine breach of contracts by securities issuers. *Sutter Home*, 971 F.2d at 408. Instead, the VR Investors' interest in their investments "is adequately protected by [those] contract remedies." *Beaudry*, 50 P.3d at 842. Indeed, VR seeks the *same* damages for its aiding and abetting contract claim (which sounds in contract) as it does for this bad-faith claim. (*Compare* Compl. ¶ 121, *with id.* ¶ 126.) *Cf. Householder Group LLLP v. Fuss*, No. C 07-573 SI, 2007 WL 1650933, at *5 (N.D. Cal. June 4, 2007) (dismissing Arizona tort claim alleging bad faith where, among other things, "the only damages plaintiff [sought] under th[e] claim [were] the same contract damages alleged under the breach of contract claim"). VR's own complaint, therefore, illustrates that "[t]he contract measure of damages is adequate." *Sutter Home*, 971 F.2d at 408.

Because the VR Investors cannot meet the special-relationship test, they are limited to contract remedies for ML's alleged breach of the implied covenant of good faith and fair dealing. *See Burkons*, 813 P.2d at 720. And because aiding-and-abetting liability does not extend to contract claims, *Covington*, 2007 WL 3208579, at *3, VR cannot assert a claim for aiding and abetting ML's breach. Count IV, therefore, must be dismissed against these Defendants.

CONCLUSION

For the foregoing reasons, the Court should dismiss all counts against Mayer Hoffman McCann P.C., CBIZ, Inc., CBIZ MHM, LLC, Charles A. and Eileen M. McLane, and Joel B. and Donna L. Kramer.

Dated: August 19, 2010

Respectfully submitted,

/s/ Katherine V. Brown

Marty Harper (#003416)
Katherine V. Brown (#026546)
POLSINELLI SHUGHART PC
3636 North Central Avenue, Suite 1200
Phoenix, Arizona 85012
Telephone: (602) 650-2000
Facsimile: (602) 264-7033
E-Mail: mharper@polsinelli.com
E-Mail: kvbrown@polsinelli.com
Local Counsel

David F. Adler
James R. Wooley
Louis A. Chaiten
Eric E. Murphy
Katie M. McVoy
JONES DAY
Northpoint
901 Lakeside Avenue
Cleveland, Ohio 44114
Telephone: (216) 586-3939
Facsimile: (216) 579-0212
Of Counsel

Attorneys for Defendants CBIZ, Inc., CBIZ MHM, LLC, Mayer Hoffman McCann PC, Charles A. and Eileen M. McLane, and Joel B. and Donna L. Kramer

CERTIFICATE OF SERVICE

I hereby certify that on August 19, 2010, I electronically filed the foregoing Joint Motion to Dismiss Complaint with the Clerk of the Court using the CM-ECF system and serve the following parties by U.S. mail:

William M. Miller, PLLC
8170 N. 86th Place, Suite 202
Scottsdale, AZ 85258
Counsel for Victims Recovery, LLC

Kevin Downey
Ellen Oberwetter
Williams & Connolly LLP
725 Twelfth Street, N.W.
Washington, D.C. 20005
Counsel for Greenberg Traurig, LLP, Robert S. and Ellen P. Kant, and Jeffrey H. Verbin

Jeffrey D. Gardner
Roska Dewulf & Patten
400 E. Van Buren, #800
Phoenix, AZ 85004
jgardner@rdp-law.com

/s/ Katherine V. Brown

8/4/08 Bus. J. (Phoenix) (Pg. Unavail. Online)
2008 WLNR 14531808

Business Journal (PHOENIX)

August 4, 2008

Rightpath pushes to convert Mortgages Ltd. Chapter 11 reorganization to Chapter 7 liquidation

Jan Buchholz

Rightpath Limited Development Group filed a motion Monday morning asking the U.S. Bankruptcy Court to convert the current Mortgages Ltd. Chapter 11 reorganization into a Chapter 7 liquidation case.

Rightpath has been embroiled in litigation with Mortgages Ltd. since mid-May, before the private commercial lender was forced into Chapter 11 bankruptcy by another developer, Grace Communities. After the bankruptcy filing in late June, the Rightpath case alleging fraud and racketeering and originally filed in Superior Court of Arizona, has been stayed and but could be resurrected through the bankruptcy proceedings.

In the meantime, Rightpath's attorneys from Sheppard Mullin Richter & Hampton LLP, say they are dissatisfied with the bankruptcy court proceedings.

In today's motion, attorney Chris Reeder asserts that Mortgages Ltd. "is comprised of self-interested insiders that have proven themselves to be completely incapable of managing the bankrupt estate. The management both past and present have allowed the depletion of assets of the estate and have given preferential treatment to a select group of creditors (the so-called director investors) and insiders to the determine of all other creditors."

Both Rightpath and Grace Communities were borrowers of large construction and/or land acquisition loans from Mortgages Ltd. in the range of $100 million and above. Both also have claimed that they never received all the money promised them by Mortgages Ltd.

Carolyn Johnson, an attorney with Jennings, Strouss & Salmon PLC who represents Mortgages Ltd. in its Chapter 11 case, said the arguments made in the latest Rightpath filing are untrue.

The bankruptcy has been mired in attacks and counterattacks by Mortgages Ltd. management and its legal counsel, various borrowers, thousands of investors and creditors, particularly since the suicide of the lender's chairman and sole shareholder, Scott Coles.

His body was discovered in his home at the base of Camelback Mountain June 2. The Maricopa County Medical Examiner's office determined he had deliberately overdosed on a combination of alcohol and drugs.

Now Rightpath says in court documents that Mortgages Ltd. "has mismanaged the bankrupt estate" and since it is no longer offering new loans or accepting new investments "there is no valid reason for keeping this case as a Chapter 11 proceeding."

Today's filing includes a declaration from C.Paul Wazzan, a Los Angeles consultant with a Ph.D. in finance from the University of California, Los Angeles, claiming that after examining deeds of trusts and other documents related to Rightpath's loan with Mortgages Ltd. he believes "irregularities" will require "a dollar by dollar forensic accounting of Mortgages Ltd."

Rightpath continues to assert that Mortgages Ltd. was involved in a Ponzi scheme, in essence taking in new money from investors to pay off older investors.

Johnsen denies the assertion and says it's the borrowers who are at fault.

"None of the arguments are compelling whatsoever and many if not most of the allegations are false," Johnsen said. "Please remember that these borrowers are in default to the company for over $109 million and have demonstrated they will stop at nothing to pre-empt their obligations."

In addition to Rightpath, which is developing the Mainstreet in Glendale mixed-use development near the new Los Angeles Dodgers-Chicago White Sox training facility, other Mortgages Ltd. borrowers who claim they were underfunded include Grace Communities, KML Development and Avenue Communities, which is developing the Centerpoint high-rise residential and retail project in downtown Tempe.

The next court hearing concerning the Mortgages Ltd. bankruptcy is scheduled for Wednesday.

EDITION: phoenix

Word Count: 744
8/4/08 BUSJPHNX (No Page)
END OF DOCUMENT