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IN THE UNITED STATES BANKRUPTCY COURT

THE DISTRICT OF ARIZONA

In re: Mortgages Ltd., Debtor.	Chapter 11 Proceedings Case No. 2:08-bk-07465-RJH
ROGER ASHKENAZI, et al., Plaintiffs, GREENBERG TRAURIG LLP, et al. Defendants.	Adversary Case No. 2:10-ap-01402-RJH **DEFENDANTS MAYER HOFFMAN MCCANN P.C., CBIZ, INC., AND CBIZ MHM, LLC'S REPLY IN SUPPORT OF JOINT MOTION TO DISMISS COMPLAINT**

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INTRODUCTION

Plaintiffs' response brief only confirms that their claims against Defendants CBIZ, Inc., CBIZ MHM, LLC (collectively "CBIZ") and Mayer Hoffman McCann P.C. ("Mayer Hoffman") must be dismissed. (Doc. 73, Resp. (hereinafter "Resp.")). Plaintiffs unsuccessfully try to gloss over the fact that, by their own allegations, any losses they suffered were derivative of losses suffered by all investors in a given LLC as a result of that LLC's investments in Mortgages Ltd. ("ML"). Even assuming their claims are direct, and not improperly derivative, they fail to follow—and then blatantly misstate in their response brief—proper pleading standards.

The response also shows how far this Court must stretch Arizona law to allow Plaintiffs' claims. For example, *Standard Chartered PLC v. Price Waterhouse*, 945 P.2d 317 (Ariz. Ct. App. 1997), unequivocally defeats their claim under the Securities Act. Plaintiffs thus contend that *Grand v. Nacchio*, 236 P.3d 398 (Ariz. 2010) (hereinafter *Grand II*), replaced the analysis in *Standard Chartered* with "sweeping language of inclusion." (Resp. 19.) But *Grand II* did no such thing. Equally true, Plaintiffs urge this Court to unreasonably expand the scope of liability for negligent misrepresentation. Under Plaintiffs' unfounded view of the law, a conclusory allegation that all investors were intended beneficiaries of Defendants' statements is enough for liability, thereby rendering the limited-group requirement for negligent misrepresentation meaningless. As for their claim under the Arizona Investment Management Act, the response proves that Plaintiffs want this Court to interpret it as another Securities Act. Their view, if accepted, would treat sellers of securities as investment advisers to the opposing purchasers.

Finally, Plaintiffs abandon most of the claims against CBIZ. The ones that have not been abandoned are insufficient as a matter of law. Under Plaintiffs' view of the Securities Act's statutory-control provision and joint-venture liability, a corporation could *never* operate under an administrative services agreement with an auditing firm, even though that kind of agreement is specifically allowed by state law and national accounting principles. That cannot be the law.

ARGUMENT

I. PLAINTIFFS' CLAIMS ARE IMPROPERLY DERIVATIVE.

As explained in our opening brief (Doc. 37, Mem. in Supp., at 9-11 (hereinafter "Mem. in Supp.")), Plaintiffs' claims must be dismissed as improperly derivative. It is well-established that LLC members may not sue for injuries to an LLC that affect all members similarly. But that is precisely what Plaintiffs attempt to do here. They claim to have become members of LLCs that purchased Pass-Through Interests in loans made by ML. (Compl. ¶¶ 6, 120, 172.) Plaintiffs' claims thus hinge on the LLCs' investment actions: If the LLCs had not invested in ML products, Plaintiffs would have no losses. Each Plaintiff's injury, therefore, was suffered as a result of an LLC's investment in ML, and was an injury suffered by all members of that LLC alike.[1]

In response, Plaintiffs repeatedly assert—in conclusory fashion—that the Complaint does not "seek[] recovery for damage done . . . to the LLCs." (Resp. 7.) It is not Plaintiffs' characterization of their claims, however, that governs. The Court must "look to all the facts of the complaint and determine for itself whether a direct claim exists." *Stephenson v. Citgo Group Ltd.*, 700 F. Supp. 2d 599, 608-09 (S.D.N.Y. 2010); *Funk v. Spalding*, 246 P.2d 184, 186 (Ariz. 1952) ("the gravamen of the complaint" controls). And to pursue a direct action, an investor must demonstrate "that he or she can prevail *without showing an injury to the corporation.*" *New York City Employees' Ret. Sys. v. Jobs*, 593 F.3d 1018, 1022 (9th Cir. 2010) (emphasis added).

Here, Plaintiffs fail to explain how the injury to an investor in an LLC can possibly exist without injury to the LLC itself when it is *the LLC* that actually purchased the supposedly worthless loans. As recognized in a case cited by Plaintiffs themselves, when a plaintiff invests in a fund that, in turn, invests in a Ponzi scheme, the plaintiff's claims are derivative of the fund's. *Stephenson*, 700 F. Supp. 2d at 609. Plaintiffs cite no authority for the proposition "that a 'passive' investment partnership is not a separate legal entity that suffers direct injury from (direct) investment in a

[1] Plaintiffs allege that not all of them invested through LLCs. They claim that some invested directly in ML. (Resp. 10.) Even if this is so, the claims of all LLC investors must be dismissed.

Ponzi scheme." *Id.* They rely instead on cases where the loss is directly, rather than indirectly, suffered by the investor.[2]

Plaintiffs also claim that their claims are necessarily direct because they are based on fraudulent inducement. (Resp. 12.) That is a gross over-simplification. A fraudulent-inducement claim can be direct or derivative, depending on the nature of the injury. Applying Arizona law, the District of Arizona has held that fraudulent-inducement claims are derivative where "the alleged wrongs primarily involve harm to [the entity in which a plaintiff invested] and to all shareholders and creditors alike." *Brazlin v. W. Sav. & Loan Ass'n*, No. 91-0078-PHX, 1994 WL 374286, at *7 (D. Ariz. Jan. 28, 1994); *see id.* at *1, *8 (holding that plaintiffs' claim—that they "were induced to purchase notes and to refrain from selling them" "as a result of" third-party lawyers' and accountants' participation in the "issuance of numerous statements and reports . . . that contained misleading statements and omissions"—was derivative because "[t]he alleged resulting injury was to [the entity itself] and similarly affected all creditors"); *see In re Sunrise Sec. Litig.*, 916 F.2d 874, 884-85 (3d Cir. 1990) (holding that fraudulent-inducement claim against former directors, officers, attorneys, and auditors of a failed savings and loan from which they had purchased certificates of deposit was derivative where the harm affected all depositors similarly); *see also Hamid v. Price Waterhouse*, 51 F.3d 1411, 1419 (9th Cir. 1995) (approving of *In re Sunrise*).

Plaintiffs' final argument is that their claims are not derivative because the amount of their damages is not directly proportional to the percentage of their ownership in the LLCs. (Resp. 10-11, 14-15.) That some LLC investors, but not others, may have received a portion of their investment back as interest is irrelevant, because each Plaintiff suffered a loss only because the

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[2] *See N.W. Racquet Swim & Health Clubs, Inc. v. Deloitte & Touche*, 535 N.W.2d 612, 619 (Minn. 1995) (plaintiffs directly purchased debentures in failed entity based on statements by accountant); *Pension Comm. of Univ. of Montreal Pension Plan v. Banc of Am. Sec. LLC*, 446 F. Supp. 2d 163, 205 (S.D.N.Y. 2006) (plaintiffs were direct investors in liquidated hedge funds and suffered individualized damages based on misrepresentations); *see also Hayes v. Gross*, 982 F.2d 104, 108 (3d Cir. 1992) (holding that plaintiffs' claims were distinct from the harm to the entity and existing shareholders because the plaintiffs alone paid inflated stock prices through direct investment in the entity); *New York City Employees' Ret. Sys.*, 593 F.3d at 1022-23 (finding plaintiffs who directly purchased stock in Apple suffered a distinct injury in the form of the denial of their personal right to an informed vote); *Pozez v. Ethanol Capital Mgmt., LLC*, No. 07-CV-00319-TUC-CKJ, 2009 WL 2176574, at *11 (D. Ariz. July 21, 2009) (plaintiffs were direct investors in limited partnership and sustained individualized harm where they were named as individuals in a contract breached by defendants and defendants' actions interfered with plaintiffs' individual obligations to perform certain tasks).

LLC first suffered the injury. *New York City Employees' Ret. Sys.*, 593 F.3d at 1022. The loss is, therefore, indirect and one that affected all LLC investors similarly.[3]

II. PLAINTIFFS CONCEDE THAT ALL CLAIMS AGAINST MAYER HOFFMAN EXCEPT NEGLIGENT MISREPRESENTATION MUST BE PLEADED WITH PARTICULARITY, BUT MISSTATE WHAT THAT STANDARD REQUIRES.

Plaintiffs do not dispute that claims that rely on an alleged "course of fraudulent conduct," *Vess v. Ciba-Geigy Corp. USA*, 317 F.3d 1097, 1126 (9th Cir. 2003)—including not just the fraud counts, but all claims based on allegations sounding in fraud—must be pleaded with particularity. (Mem. in Supp. 13.) Nor do Plaintiffs dispute that this rule requires all counts against Mayer Hoffman, except the negligent-misrepresentation count, to be pleaded with particularity.

Plaintiffs instead assert that they have indeed pleaded with particularity. Their argument rests exclusively on a statement in a district court case from 1984 that Rule 9(b) requires just "fair notice of what . . . Plaintiffs' claim is and the grounds upon which it rests," and simply "forbid[s]" "conclusory allegations." *Jordan v. Madison Leasing Co.*, 596 F. Supp. 707, 711 (S.D.N.Y. 1984). According to Plaintiffs, "Mayer Hoffman attempts to unreasonably impose additional pleading burdens on Plaintiffs through Rule 9(b)." (Resp. 16.) Plaintiffs and the *Jordan* opinion, however, blatantly misstate the law. As controlling law indicates, they "collapse Rule 9(b) into Rule 8(a), which requires . . . a statement 'that will give the defendant fair notice of what the plaintiffs' claim is and the grounds upon which it rests' . . . . But Rule 9(b) clearly imposes *an additional obligation* on plaintiffs" to plead fraud-based allegations "with particularity." *In re GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541, 1547 (9th Cir. 1994) (en banc) (emphasis added) (quoting *Conley v. Gibson*, 355 U.S. 41, 47 (1957)); *see also In re White Electronic Designs Corp. Sec. Litig.*, 416 F. Supp. 2d 754, 761 (D. Ariz. 2006) ("*Rule 8* . . . requires only that a plaintiff give a defendant 'fair notice of what the plaintiff's claim is and the grounds upon which it rests.' *Rule 9(b)*, though, imposes *an additional obligation* when pleading fraud.") (emphasis added) (citation omitted). Because Plaintiffs plead claims grounded in allegations of fraud, it is well-established that they must plead

[3] Also unavailing is Plaintiffs' assertion that there should be no derivative claim because some members of the LLC may have been involved in the wrongdoing. That is a common feature of a derivative action. The individuals accused of wrongdoing are often shareholders of the corporation (*e.g.*, directors or officers who own stock in the corporation). But that does not make the action direct rather than derivative.

more than just enough to give Defendants "fair notice of what the . . . claim is and the grounds upon which it rests." They must plead specific facts alleging the "who, what, when, where, and how" of their fraud-based claims. *Kearns v. Ford Motor Co.*, 567 F.3d 1120, 1124 (9th Cir. 2009).

Plaintiffs do not seriously argue that the Complaint satisfies the "who, what, when, where, and how" standard. They note that they have filed a "*60-page* Complaint." (Resp. 15) (emphasis added). But a prolix complaint, larded with conclusory assertions, is no substitute for the specific facts. "[T]he heightened pleading rules are designed to elicit clarity, not volume." *In re PetSmart, Inc. Sec. Litig.*, 61 F. Supp. 2d 982, 991 (D. Ariz. 1999); *see Williams v. WMX Techs., Inc.*, 112 F.3d 175, 178 (5th Cir. 1997) ("A complaint can be long-winded, even prolix, without pleading with particularity. Indeed, such a garrulous style is not an uncommon mask for an absence of detail.").

Nor, contrary to Plaintiffs' assertion, does the law excuse them from alleging "each particular audit report [each plaintiff] received and which representation [each plaintiff] relied upon in making its investments." (Resp. 16-17.) According to Plaintiffs, that is not required because they have pleaded "identical misrepresentations and omissions made by Mayer Hoffman to each Plaintiff." (*Id.*) Plaintiffs are wrong. To begin with, on page 7 of their response, they argue (when it is convenient for them to do so) that their claims are direct and not derivative because the Complaint "entail[s] multiple instances of . . . *reliance specific to each Plaintiff*." (*Id.* at 7) (emphasis added). Ten pages later, they argue that they do not have to plead the details of which particular Plaintiffs received, read, and relied on which alleged misrepresentation because reliance was supposedly *the same* for each Plaintiff. (*Id.* at 17.) Plaintiffs cannot have it both ways. In any event, the law does not excuse pleading with particularity even where plaintiffs received identical statements. *Moore v. Kayport Package Exp., Inc.*, 885 F.2d 531, 540 (9th Cir. 1989). And even if it did, the Complaint alleges that different misrepresentations and omissions were contained in different audit reports.[4] The Complaint must, but fails to, "specify when [each Plaintiff] was

[4] Compl. ¶ 169 ("[T]he Financial Statements served to mask the fact that the Company was insolvent from at least October 2005 on, [and] that the Company was effectively out of business by mid-2007. . . ."); ¶ 173 ("Had the 2005 financial statements for Mortgages Ltd. been properly consolidated, the balance sheet would have shown a debt-to-equity ratio of a staggering 248 to 1 rather than the 10.7 to 1 ratio

exposed to [the allegedly false statements] [and] which ones [each Plaintiff] found material." *Kearns*, 567 F.3d at 1126; *Moore*, 885 F.3d at 540 (dismissing complaint because "the prospectuses are not specifically identified as to content, date or author[,] [and] [t]he complaint does not specify which plaintiff received which prospectus, or which plaintiff(s) made purchases through the stockbroker defendants, or which securities the investors allegedly purchased").

Nor does the Complaint provide any basis for presuming that Plaintiffs relied on any alleged misrepresentation or omission. Plaintiffs assert that reliance essentially can be presumed because "these misrepresentations and omissions went to the very heart of whether ML was a fraudulent enterprise or a solvent business." (Resp. 17.) Courts, however, find this presumption of reliance appropriate only "when the plaintiffs' actions could not be explained in any way other than reliance on the defendants' misrepresentations." *Martinelli v. Petland, Inc.*, No. CV-09-529-PHX-DGCI, 2010 WL 376921, at *3 (D. Ariz. Jan. 26, 2010). Here, Plaintiffs' purchases may be explained on numerous independent grounds. They may have relied on the allegedly misleading representations in the Private Offering Memoranda ("POMs") themselves, rather than any statement by Mayer Hoffman. (Compl. ¶ 122.) They may never have read or even seen Mayer Hoffman's audit report. They may not have known who Mayer Hoffman was or that Mayer Hoffman made any statements about ML. An investor obviously cannot rely on a representation that he does not even know about. That is why courts find "[t]he actual receipt and consideration of any misstatement . . . central." *Kaufman v. i-Stat Corp.*, 754 A.2d 1188, 1195 (N.J. 2000).

that it did show . . . ."); ¶ 174 ("Beginning with the financial statements for the year ended [December 31,] 2006, in a note under 'Notes Payable,' the Financial Statements state that a large balance is owed to an 'investor' or 'lender' . . . ."; ¶ 180 ("Had the loans been written down to their fair market value in 2007, the balance sheet would not have shown $8.2 million in equity but negative equity . . . in the tens of millions.")

III. PLAINTIFFS HAVE NOT STATED A COGNIZABLE CLAIM AGAINST MAYER HOFFMAN FOR VIOLATING THE ARIZONA SECURITIES ACT OR FOR AIDING AND ABETTING A VIOLATION.

A. Plaintiffs Concede That Mayer Hoffman Did Not Make Or Participate In Securities Sales, And They Fail To Distinguish *Standard Chartered*'s Holding Regarding Inducement.

Plaintiffs do not, and cannot, dispute that the Arizona's securities-fraud statute allows a private investor to sue only a "person . . . who made, participated in or induced the unlawful sale." A.R.S. § 44-2003(A). Nor do Plaintiffs even attempt to argue that Mayer Hoffman "made" or "participated in" sales of securities. Plaintiffs instead assert that Mayer Hoffman "induced" an unlawful sale. (Resp. 18-20.) But the decision of the Arizona Court of Appeals (the same division to which Plaintiffs would take an appeal if the case were is state court) in *Standard Chartered* is squarely on point.

Plaintiffs argue that *Standard Chartered* does not apply because *Grand II* replaced the "parsed" and "restrictive reading" of the words "participate" and "induce" in *Standard Chartered* with "*sweeping language of inclusion.*" (Resp. 14.) But *Grand II* cited *Standard Chartered* approvingly no less than *seven* times. 236 P.3d at 401-03. That case *incorporated Standard Chartered*, including its definitions of "participate" and "induce."

Plaintiffs further contend that *Grand II* eliminated any requirement that a plaintiff "parse" in the complaint whether a defendant made, participated in, or induced a sale. (Resp. 19.) But that passage simply indicates that, so long as a defendant's behavior constitutes making, participating in, or inducing a securities sale, there is no need to parse which behavior constitutes "making" versus "inducing" versus "participating." *Id.* at 401. Nowhere, however, does the Court suggest that there can be a primary violation of the Securities Act if a defendant's behavior does not constitute *any* of the three prohibited actions.

What is more, *Grand II* approvingly cited *Standard Chartered's* definition of induce on multiple occasions, and equated "induce" with "encourage," 236 P.3d at 402-03, a verb with an "active construction" like the synonyms used by *Standard Chartered.* 945 P.2d at 332. Plaintiffs

do not allege anything like this active persuasion of investors by Mayer Hoffman, only that ML included Mayer Hoffman's audited financial statements in materials ML provided to investors.

Nor, contrary to Plaintiffs' assertion, did *Grand II* hold an "omission" alone could qualify. (Resp. 20.) *Grand II* noted that inducement could occur through "*acts and* omissions" that, together, "*encourage* [a plaintiff] to buy [securities]." 236 P.3d at 403 (emphases added). An omission that leads a plaintiff to buy a stock is not an inducement, therefore, unless it is combined with the encouraging "acts" present in *Grand II* but lacking here and in *Standard Chartered*. *Id.*

Finally, Plaintiffs attempt to distinguish *Standard Chartered* on the ground that, in that case, "the audit materials were provided to the plaintiff during *due diligence*." (Resp. 20 (emphasis added).) That is a distinction without a difference. In both cases, the audited financials were part of the universe of information provided before a purchase was *consummated*. But in neither case did the auditor do anything more than "provide [only indirectly, in the case of Mayer Hoffman] information that contribute[d] to [the buyer's] decision to close the deal," which does not constitute inducement as a matter of law. *Standard Chartered*, 945 P.2d at 333.[5]

B. Plaintiffs Do Not Adequately State A Claim For Aiding And Abetting Securities Fraud.

Plaintiffs' attempt at pleading a claim for aiding and abetting securities fraud fails for the three reasons given in our opening brief, to which Plaintiffs offer no serious response.

First, as explained, the Arizona Securities Act does not include a cause of action for aiding and abetting. (Mem. in Supp. 17-18.) Plaintiffs misrepresent what the Arizona Supreme Court recently said about the issue. According to Plaintiffs, the Arizona Supreme Court's 1979 recognition of a private right of action for aiding and abetting "stands as the law currently controlling the issue," and the Arizona Supreme Court recently declined to reverse itself. (Resp.

[5] Neither *Burritt v. NutraCea*, No. CV-09-00406-PHX-FJM, 2010 WL 668806 (D. Ariz. Feb. 25, 2010), nor *Oster v. Kirschner*, 905 N.Y.S.2d 69 (App. Div. 2010), cited on pages 19-20 of Plaintiffs' brief, supports a finding of inducement here. *Burritt* actually acknowledges that the Act "does not reach outsiders to a securities sale who merely provide information that foreseeably contributes to, and thereby influences, a purchaser's decision." Inducement was found in *Burritt* because, unlike here, defendants made the alleged misstatements *directly* to investors, on conference calls with them. For its part, the *Oster* court never even uses the word "induce" to describe defendants' activities there, and the case involved a completely unrelated cause of action.

20-21, quoting *Wojtunik v. Kealy*, 394 F. Supp. 2d 1149, 1170 (D. Ariz. 2005).) But on August 5, 2010, the Arizona Supreme Court expressly stated in *Grand II* that the question of whether the Securities Act allows a private right of action for aiding and abetting is "open." 236 P.3d at 404.[6]

Since the question is an open one, the Court must predict how the Arizona Supreme Court will rule on the question when forced to decide it. The answer is obvious. The legislature did not expressly include a cause of action for aiding and abetting in the Securities Act when it clearly knows how to do so. A.R.S. § 12-812, §§ 40-491(f), 492. And the primary support for allowing such an action in 1979 was a United States Supreme Court case that has since been *overruled*.

Plaintiffs fixate on the "sweeping language of inclusion" reference from *Grand II*. From there, they argue that a "sweeping interpretation" of *Grand II*'s definition of participate—"to take part in something . . . in common with others," 236 P.3d 402-03—provides a cause of action for aiding and abetting. The argument is completely atextual. *Grand II*'s definition simply defines what conduct constitutes a *primary violation*. Not even a "sweeping interpretation" can read into the Act a cause of action that it simply does not include. *See New Sun Bus. Park, LLC v. Yuma County*, 209 P.3d 179, 183 (Ariz. Ct. App. 2009) (The court is "not at liberty to rewrite the statute under the guise of judicial interpretation.").

Second, Plaintiffs offer no meaningful response to the argument that a private cause of action for aiding and abetting, even if it existed, would require Plaintiffs to show that Mayer Hoffman participated in or induced unlawful securities sales. (Mem. in Supp. 18-19). Plaintiffs' only response is to assert that *Grand II*'s "sweeping interpretation" of the Securities Act somehow eliminates that requirement. Not so. In *Grand v. Nacchio*, 217 P.3d 1203 (Ariz. Ct. App. 2009) (*Grand I*), the court expressly held that the requirement would apply to any aiding-and-abetting claim. *Id.* at 1208-10. And that portion of *Grand I* remains controlling law, as *Grand II* did not opine on the issue. 236 P.3d at 403. "[A] federal court sitting in diversity must follow an intermediate state court decision unless other persuasive authority convinces the federal court that

[6] Plaintiffs' reliance on the Arizona Corporation Commission's decision in *In re John Edward Tencza*, No. S-20483A-06-0661, 2007 WL 2478687 (Ariz. Corp. Comm'n Aug. 13, 2007) is misplaced because it was decided before the Arizona Supreme Court's 2010 decision in *Grand II*.

the state supreme court would decide otherwise." *Richardson v. United States*, 841 F.2d 993, 996 (9th Cir. 1988) (emphasis added).

Third, Plaintiffs have failed to adequately plead that Mayer Hoffman *knew* that it was substantially assisting conduct constituting securities fraud. (Mem. in Supp. 19-21.) Plaintiffs ignore the requirement that they plead with particularity a "strong inference of scienter." (*Id.* 19-20.) They fail to address the cases cited in our opening brief holding that GAAP and GAAS violations alone are never enough to establish the scienter required for securities fraud or aiding-and-abetting securities fraud. They fail to address the cases holding that "red flags" or mere knowledge of suspicious activity is not enough. And while Plaintiffs state that "a duty of inquiry" or "general knowledge" is sufficient to support a claim for aiding and abetting, they do not cite a single case in which a court has found that an auditors' mere suspicion or knowledge of some irregularities in company business is sufficient. The law of Arizona is that the red flags identified in the Complaint simply do not suffice to allege knowledge. *Stern v. Charles Schwab & Co., Inc.*, No. CIV-09-1229-PHX-DGC, 2010 WL 1250732, at *11 (D. Ariz. Mar. 24, 2010); *Colson v. Maghami*, No. CV 08-2150-PHX-MHM, 2010 WL 2744682, at *9 (D. Ariz. July 9, 2010). Plaintiffs would turn the greater scienter requirement for aiding-and-abetting securities fraud into a way to recover for mere negligence. No court has ever accepted that theory.[7] Finally, Plaintiffs fail even to hint at what possible motivation Mayer Hoffman would have to knowingly assist an alleged $900-million fraud scheme. (Mem. in Supp. 21.)

Plaintiffs' aiding-and-abetting claim must be dismissed for any of these three independent reasons.

IV. PLAINTIFFS HAVE NOT STATED A COGNIZABLE CLAIM AGAINST MAYER HOFFMAN FOR VIOLATING THE ARIZONA CONSUMER FRAUD ACT OR FOR AIDING AND ABETTING A VIOLATION.

Plaintiffs concede that they are required to plead that Mayer Hoffman knowingly participated in a fraud to establish that it violated the Consumer Fraud Act or aided and abetted a

[7] Contrary to Plaintiffs' assertion, *Grand II*, which declined to address whether aiding-and-abetting liability even exists, does not allow for aiding-and-abetting liability based on negligence.

violation. (Resp. 25.) But Plaintiffs have failed to allege facts plausibly establishing that Mayer Hoffman *knowingly* (as opposed to *negligently at worst*) participated in a fraud, for reasons stated in our opening brief (Mem. in Supp. 21-22) and in Section III above.

In an attempt to avoid dismissal of their Consumer Fraud Act claims on statute of limitations grounds, Plaintiffs misstate the standard for the discovery rule. (Resp. 25.) Their argument rests on the United States Supreme Court's decision in *Merck & Co., Inc. v. Reynolds*, 130 S. Ct. 1784 (2010), which held that "inquiry notice"—which "refers to the point where facts would lead a reasonably diligent plaintiff to investigate further"—does not trigger the discovery rule under the statute at issue there. *Id.* at 1797-98. Unlike the statute at issue in *Merck*, however, "inquiry notice" is enough to trigger the statute of limitations for Arizona's Consumer Fraud Act: "An action accrues under [§ 44-1522] 'when a defrauded party discovers or *with reasonable diligence could have discovered* the fraud.'" *Cervantes v. Countrywide Home Loans, Inc.*, No. CV-09-517-PHX-JAT, 2009 WL 3157160, at *7 (D. Ariz. Sept. 24, 2009) (quoting *Alaface v. Nat'l Inv. Co.*, 892 P.2d 1375, 1379 (Ariz. Ct. App. 1994)). There is no requirement that the plaintiff have knowledge of each element necessary to his claim. *Polk v. State*, --- P.3d ---, 2010 WL 392778, at *4 (Ariz. Ct. App. 2010); *Estate of Kirschenbaum v. Kirschenbaum*, 793 P.2d 1102, 1105 (Ariz. Ct. App. 1989).

Based on identical rules, courts uniformly find that a company's precipitous decline following closely on the heels of rosy financial statements puts a plaintiff on notice of potential fraud claims against the accounting firm auditing the company. *See, e.g., City Nat'l Bank of Fla. v. Checkers, Simon & Rosner*, 32 F.3d 277, 284 (7th Cir. 1994) (fraud action accrued when client could not pay loan raising questions as to accuracy of financial compilations prepared by auditing firm). There is no need for the plaintiff to have evidence of the firm's state of mind so long as the facts available to the plaintiff reveal an inexplicable inconsistency between the financial statements and the actual state of the company. Those are precisely the facts alleged here. According to Plaintiffs, Mayer Hoffman issued clean audit reports indicating that ML was a going concern mere months before it was forced into bankruptcy.

Even if those facts did not suffice to put Plaintiffs on notice, two months after ML entered bankruptcy (and more than one year before this case was filed), there were allegations both in court pleadings and in newspapers that ML was operating a Ponzi scheme. (Mem. in Supp. 23-24.) Such public allegations of inaccurate financial reporting are also sufficient, standing alone, to have put Plaintiffs on notice of their claims and triggered the running of the limitations period. *In re Enter. Mortgage Acceptance Co., LLC Sec. Litig.*, 391 F.3d 401, 411 (2d Cir. 2005) (holding that investors were on notice of their claims against Ernst & Young based on newspaper articles "which suggested that [the corporation in which plaintiffs invested] had been engaging in 'accounting gimmicks' and other 'creative accounting' practices").[8]

Finally, in response to the argument that the Consumer Fraud Act does not prohibit aiding and abetting, Plaintiffs merely refer back to the arguments concerning aiding-and-abetting liability under the Securities Act. For reasons stated above, those arguments are erroneous.

V. PLAINTIFFS HAVE NOT STATED A CLAIM AGAINST MAYER HOFFMAN FOR VIOLATING THE INVESTMENT MANAGEMENT ACT OR FOR AIDING AND ABETTING A VIOLATION.

Plaintiffs cannot proceed against Mayer Hoffman under the Investment Management Act because they seek to recover for *securities* transactions, not *investment advisory service* transactions. (Mem. in Supp. 25-27.) Plaintiffs' response mischaracterizes our opening brief as arguing that the Investment Management Act applies only to investment advisors. Plaintiffs then respond to the mischaracterization by pointing out that the Act's private right of action "applies to any 'person.'" (Resp. 24.) Defendants do not dispute that the Act extends to persons other than investment advisors. But simply because a plaintiff can sue *any person* does not mean that they can sue over *anything*. Rather, the suit must be about "a transaction . . . involving . . . investment advisory services." A.R.S. § 44-3241(A)-(B).

Relying on *Grant v. Arthur Andersen, L.L.P.*, No. CV1999-019093, 2001 WL 35976018 (Ariz. Super. Ct. Feb. 16, 2001), Plaintiffs argue that the provision of financial reports at the time a

[8] Contrary to Plaintiffs' claim that this is an issue for discovery, a court may grant a motion to dismiss based on the statute of limitations "[w]here it is apparent from the undisputed facts . . . that only one conclusion can be drawn." *City Nat'l Bank*, 32 F.3d at 283 (internal quotation marks and citations omitted).

security is sold constitutes "investment advisory services." (Resp. 24.) *Grant*, however, only addressed the question of whether the Investment Management Act covered persons other than investment advisors. It never addressed the scope of the term "investment advisory services." In fact, Plaintiffs' theory is unprecedented. All salespeople discuss the qualities of the securities they sell. If that is enough to turn a securities transaction into an investment-advisory-services transaction, this Court must treat *every* securities seller as an adviser to the purchaser *on the other side of the transaction*. Plaintiffs would make the Securities and Management Acts redundant.

Not surprisingly, the Investment Management Act's text confirms that securities transactions do not, by themselves, qualify. The Act is limited to a "a transaction . . . involving . . . investment advisory services," A.R.S. § 44-3241(A)-(B), namely, an exchange of those services for money. That is confirmed by the canon of construction that the Securities and Managements Acts should be read not to be redundant. *See In re MH 2008-002659*, 226 P.3d 394, 397 (Ariz. Ct. App. 2010). The Act thus applies, for example, to contracts between financial planners and clients. But it does not apply where, as here, a plaintiff simply purchases securities.

Plaintiffs' Investment Management Act claim fails for other, independent reasons, too. As discussed above in Section II.B, Plaintiffs have not adequately alleged individual reliance. *See Caviness v. Derand Res. Corp.*, 983 F.2d 1295, 1305 (4th Cir. 1993). Plaintiffs' response refers to the "reliance" argument discussed in Part V of their brief, discussing the Securities Act. That section of the their brief, however, does not mention reliance. Plaintiffs also fail to respond to the argument that the Investment Management Act does not include aiding and abetting liability (Mem. in Supp. 28-29), other than to refer to its erroneous arguments regarding the Securities Act.

VI. PLAINTIFFS HAVE NOT STATED A COGNIZABLE CLAIM AGAINST MAYER HOFFMAN FOR AIDING AND ABETTING A BREACH OF FIDUCIARY DUTY.

Plaintiffs concede that they must adequately allege that Mayer Hoffman knew that ML's conduct constituted a breach of fiduciary duty. They instead argue that there is no heightened pleading requirement for pleading knowledge. It is true that knowledge may be averred generally under the federal rules, but "[t]hreadbare recitals of the elements of a cause of action, supported by

mere conclusory statements, [nevertheless] do not suffice." *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009); *see Knievel v. ESPN*, 393 F.3d 1068, 1073 (9th Cir. 2005) (holding that federal—not state—standards govern whether a court should dismiss a complaint). To comport with *Iqbal*'s requirements, a plaintiff must allege *facts plausibly showing* that Mayer Hoffman knowingly assisted ML violate the law. *Stern*, 2010 WL 1250732, at *8. Plaintiffs' allegations fall short of that standard, for reasons stated in our opening brief and in Section III.B above.

VII. PLAINTIFFS CANNOT BRING A NEGLIGENT-MISREPRESENTATION CLAIM AGAINST MAYER HOFFMAN.

A. Plaintiffs Seek To Render The Limited-Group Requirement Meaningless.

Under Restatement (Second) of Torts § 552, an auditor faces liability to investors only if they are "specifically intended beneficiaries." *Gillespie v. Schneider*, No. 94-55995, 1996 WL 111593, at *2 (9th Cir. Mar. 13, 1996) (internal quotation marks omitted). To attempt to satisfy this rule, Plaintiffs cite the Complaint's allegations that Mayer Hoffman "consented" to and had full "knowledge" of the use of its reports. (Resp. 32.) But those conclusory allegations "are not entitled to the assumption of truth." *Iqbal*, 129 S. Ct. at 1951. They are *identical* to the allegations held to be insufficient in *Iqbal*. In *Iqbal*, plaintiff alleged that defendants "'knew of'" and "'agreed to'" certain conduct. *Id.* The Court held that those allegations must be disregarded. Thus, contrary to Plaintiffs' assertion, Defendants are not trying to "contradict these . . . allegations of fact" or "require[] different rules of pleading." (Resp. 30-31.) The federal pleading standard, as explained in *Iqbal*, applies to this claim. *See Knievel*, 393 F.3d at 1073. And that standard requires Plaintiffs' conclusory assertions to be disregarded.

Disregarding Plaintiffs' conclusory allegations, this case falls squarely within Illustration 10 to § 552. (Mem. in Supp. 32-33.) None of the cases cited by Plaintiffs suggests otherwise. Those cases only serve to confirm that the limited-group requirement is, in fact, a limited-group requirement. In *Sage v. Blagg Appraisal Co., Ltd.*, 209 P.3d 169 (Ariz. Ct. App. 2009), for example, the defendant appraiser valued a home for a mortgage lender. The court found that the appraiser owed a duty to the purchaser (a limited class of one). *Id.* at 172. *Sage* adopted this rule

because "imposition of this duty [there] [did] not impair the Restatement's purpose of delimiting what otherwise might be a boundless number of persons." *Id.* at 174-75. In *Hayes v. Arthur Young & Co.*, 34 F.3d 1072 (Table), 1994 WL 463493 (9th Cir. 1994), Arthur Young audited *offering documents* for a specific partnership being presented as an investment vehicle, limiting the group to recipients of those specific offering documents. *Id.* at *15. And in *Merrick Bank Corp. v. Saavis, Inc.*, No. CIV 09-1088-PHX-CKJ, 2010 WL 148201 (D. Ariz. Jan. 11, 2010), the plaintiff had already agreed to invest *before* the audit. As a result, it "was a member of a limited group of banks, distinct from the much larger class who might reasonably be expected sooner or later to have access to the information and to foreseeably take some action in reliance upon the information." *Id.* at *9.

Here by contrast, the Complaint lacks non-conclusory allegations that Mayer Hoffman knew its audit reports would be given to specific investors. Furthermore, the ninety plaintiffs here cannot possibly be a "limited group," because there is nothing to distinguish their allegations from those that could be made by all ML investors. To allow this claim to proceed "would render [the limited-group] requirement meaningless." *Scottish Heritable Trust, PLC v. Peat Marwick Main & Co.*, 81 F.3d 606, 613 (5th Cir. 1996).[9]

B. Plaintiffs Seek To Eliminate Any Reliance Element From Arizona Law.

Plaintiffs' "presumption of reliance" arguments are wrong for reasons already stated, *supra* at 6. Plaintiffs make one reliance argument in the negligent-misrepresentation section of their brief that is not covered above. They clam that they should get a "presumption of reliance" because their claims are "based on the omission of material fact." (Resp. 32.) But no Arizona negligent-misrepresentation case has adopted this presumption. The only case Plaintiffs cite—*Trimble v. American Savings Life Insurance Co.*, 733 P.2d 1131 (Ariz. Ct. App. 1986)—involved securities laws. *See id.* at 1135-36. It was reasonable for *Trimble* to adopt the presumption of *Affiliated Ute*

[9] *See Grant Thornton LLP v. Prospect High Income Fund*, 314 S.W.3d 913, 921 (Tex. 2010) ("that only certain investors bought [securities] does not make [them] a 'limited group'"); *WM High Yield Fund v. O'Hanlon*, No. 04-3423, 2005 WL 1017811, at *16 (E.D. Pa. Apr. 29, 2005) ("a class of securities investors [does] not qualify as a 'limited group'"); *In re ML-Lee Acquisition Fund II, L.P. and ML-Lee Acquisition Fund (Retirement Accounts) II, LP Sec. Litig.*, 848 F. Supp. 527, 556 (D. Del. 1994) (refusing to "extend[] liability . . . to the general investing public").

Citizens of Utah v. United States, 406 U.S. 128 (1972) for federal securities law, because Arizona courts look to federal law when interpreting state securities laws. *State v. Gunnison*, 618 P.2d 604, 606 (Ariz. 1980). But Arizona would follow the cases that have declined to transfer this presumption to the common law. *See Mirkin v. Wasserman*, 858 P.2d 568, 571 n.2 & 574 (Cal. 1993) ("see[ing] no reason to adopt the *Ute* presumption"); *Waters v. Int'l Precious Metals Corp.*, 172 F.R.D. 479, 502 (S.D. Fla. 1996) (same). In any event, this is not a pure omissions case, but a mixed case of affirmative misrepresentations and omissions. As such, even if a presumption exists in omission cases, it does not apply here. *Grimmelmann v. Pulte Home Corp.*, No. CV-08-1878-PHX-FJM, 2010 WL 2744943, at *8 (D. Ariz. July 9, 2010) ("Because plaintiffs' . . . negligent misrepresentation claims are best described as 'mixed claims' of omissions and affirmative misrepresentations, the presumption of reliance is not available.").

VIII. CBIZ IS NOT LIABLE.

A. Plaintiffs Concede That CBIZ Cannot Be Held Directly Liable.

Plaintiffs have abandoned their attempt to hold CBIZ liable under most of the counts that expressly name CBIZ as a defendant: aiding and abetting ML's securities fraud (Count II), aiding and abetting ML's breach of fiduciary duties (Count III), negligent misrepresentation (Count IV), Consumer Fraud (V), aiding and abetting ML's consumer fraud (Count VI), the Investment Management Act (Count VIII), and aiding and abetting ML's violation of the Investment Management Act (Count IX). (Resp. 34). Plaintiffs had no good-faith basis for including CBIZ in those counts.

B. CBIZ Cannot Be Held Liable For Controlling Mayer Hoffman's Audits.

Plaintiffs' statutory-control claim (Count I) fails because: (1) their primary-liability claim against Mayer Hoffman fails; (2) CBIZ did not participate in or induce securities sales; and (3) CBIZ had no right to control Mayer Hoffman's audits. (Mem. in Supp. 33-38.) Plaintiffs do not respond to the first point, conceding that they cannot bring a control claim if their primary claim fails. Their positions on the other two grounds fare no better.

1. CBIZ did not participate in or induce ML securities sales.

Plaintiffs' control claim cannot stand because the provision under which they sue—§ 44-2001—requires them to show that CBIZ "made, participated in or induced the unlawful sale" of securities. A.R.S. § 44-2003(A). They concede they have not done so, arguing only that this rule does not apply to defendants alleged to be control persons. (Resp. 33.) But *Grand I* determined that it did. 217 P.3d at 1208-10. That portion of *Grand I* remains controlling law, as *Grand II* did not provide an opinion on the issue. 236 P.3d at 403; *see Richardson*, 841 F.2d at 996.

2. CBIZ could not legally control Mayer Hoffman's audits.

Plaintiffs' claim would fail even if they had adequately alleged that CBIZ participated in or induced unlawful sales. Plaintiffs' allegations that CBIZ received 85% of Mayer Hoffman's gross revenue in exchange for providing Mayer Hoffman with the employees, office space, and services needed for audits, are insufficient as a matter of law to establish control. (Resp. 36.) The alleged control person must "possess[] the power to control the *specific transaction or activity* upon which the primary violation is predicated." *Brown v. Enstar Group, Inc.*, 84 F.3d 393, 396 (11th Cir. 1996) (emphasis added) (internal quotation marks omitted). Plaintiffs do not allege that CBIZ directed Mayer Hoffman on the procedures to follow when conducting its audits or that CBIZ had the power to do so. To the contrary, they allege that CBIZ "is prevented from providing audit and other attest services." (Compl. ¶ 181.) And the assertion that there was only an "illusion of independence" (Resp. 37) is the exact type of "label[] and conclusion[]" that "will not do." *Iqbal*, 129 S. Ct. at 1949 (internal quotation marks omitted).

Having failed to allege that CBIZ had the power to control Mayer Hoffman's audit procedures, Plaintiffs must claim that the law requires only *generalized control* over the person, not control over the specific activity in question. But *Eastern Vanguard Forex, Ltd. v. Arizona Corporations Commission* makes clear that Arizona law requires "the legal power . . . to control the *activities* of the primary violator." 79 P.3d 86, 99 (Ariz. Ct. App. 2003) (emphasis added). And it comports with federal law, which the Arizona legislature directed state courts to consider. 1996 Ariz. Sess. Laws, ch. 197, § 11(C) ("The courts may use as a guide the interpretations given by the

securities and exchange commission and the federal or other courts in construing substantially similar provisions in the federal securities laws of the United States."); *see Maher v. Durango Metals, Inc.*, 144 F.3d 1302, 1306 n.8 (10th Cir. 1998) ("[C]ourts generally agree that the plaintiff need[s] [to] show the power to control the transaction underlying the alleged securities violation.").

C. Plaintiffs' Joint-Venture Theory Fails For The Same Reasons.

Plaintiffs' joint-venture claim cannot stand both because the primary claims against Mayer Hoffman fail and because CBIZ and Mayer Hoffman could not conduct a joint venture as a matter of law. (Mem. in Supp. 33-38.) In response to the first basis for dismissal, Plaintiffs merely claim that they have stated claims against Mayer Hoffman. They do not dispute that they cannot bring a joint-venture claim against CBIZ if their claims against Mayer Hoffman fail. Instead, Plaintiffs challenge CBIZ's argument that it lacked the "equal right to control" Mayer Hoffman's audits. *Tanner Cos. v. Superior Court*, 696 P.2d 693, 695 (Ariz. 1985). They first assert that members in a joint venture may delegate control over the activity to a specific member. (Resp. 38.) But that does not help them. CBIZ's lack of control does not stem from its delegation to Mayer Hoffman. It stems from accounting rules prohibiting that control. CBIZ never had a "right to be heard in control and management of the venture." *Estate of Hernandez ex rel. Hernandez-Wheeler v. Flavio*, 930 P.2d 1309, 1313 (Ariz. 1997).

Plaintiffs also contend that the control element is for discovery. (Resp. 36-37.) To the contrary, numerous courts have dismissed similar vicarious-liability claims for failure to adequately allege control.[10]

Finally, Plaintiffs assert that the joint-venture disclaimer in the Administrative Services Agreement is not dispositive. (Resp. 40.) Even if that were so, Plaintiffs' claim would still fail. The disclaimer in this case is *required* by accounting rules that prohibit the control element

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[10] *Secon Serv. Sys., Inc. v. St. Joseph Bank and Trust Co.*, 855 F.2d 406, 416-17 (7th Cir. 1988) (dismissing complaint for failure to plead control); *Star Energy Corp. v. RSM Top-Audit*, No. 08 Civ. 00329, 2008 WL 5110919, at *3 (S.D.N.Y. Nov. 26, 2008) (dismissing vicarious liability claim because umbrella accounting firm's association with allegedly negligent member firm insufficient to plead control); *In re Parmalat Secs. Litig.*, 377 F. Supp. 2d 390, 407 (S.D.N.Y. 2005) (same).

necessary for a joint venture. Plaintiffs have identified no case where the disclaimer reinforced background legal rules. Both as a *contractual* and a *legal* matter, CBIZ could not control Mayer Hoffman's audits. (Mem. in Supp. 36-37.) These factors *together* show that the Court must dismiss Count X. To hold otherwise would require this Court to find that CBIZ and Mayer Hoffman must violate accounting rules.

IX. PLAINTIFFS' REQUEST TO AMEND THE COMPLAINT SHOULD BE DENIED.

Plaintiffs' request for leave to amend the Complaint (Resp. 41) should be denied. "Local Rule of Civil Procedure 15.1 requires parties who move to amend a pleading to attach a copy of the proposed amended pleading as an exhibit to the motion." *Cettolin v. GMAC*, No. 10-8036-PCT-JAT, 2010 WL 3834628, *4 (D. Ariz. Sept. 24, 2010); *see* Local Bankr. R. 9014-1 (incorporating federal rules). Plaintiffs did not do so. Nor, in any event, have they explained how an amended complaint would cure any of the fundamental deficiencies discussed in Defendants' briefs.

CONCLUSION

For the foregoing reasons, the Court should dismiss all Counts against Mayer Hoffman McCann P.C., CBIZ, Inc., and CBIZ MHM, LLC.

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DATED October 22, 2010.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on October 22, 2010, I electronically transmitted the attached document to the Clerk's office using the CM/ECF System for filing and transmittal of a Notice of Electronic Filing to the CM/ECF registrants. I further certify that I served the attached document by U.S. mail on the following who are not registered participants of the CM/ECF System:

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