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UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ARIZONA

ML SERVICING CO., INC., an Arizona corporation; and ML LIQUIDATING TRUST, Plaintiffs, v. GREENBERG TRAURIG, LLP, a New York limited liability partnership; ROBERT S. KANT and ELLEN P. KANT, husband and wife; JOHN AND JANE DOES 1-30; BLACK CORPORATIONS 1-30; WHITE PARTNERSHIPS 1-30; and GRAY TRUSTS 1-30, Defendants.	No. 2:11-CV-00832-DGC **MOTION TO REMAND THE CASE TO MARICOPA COUNTY SUPERIOR COURT** (Assigned to the Honorable David G. Campbell) (Oral Argument Requested)

Plaintiffs hereby respectfully request that the Court remand this case to Maricopa County Superior Court because this Court lacks subject matter jurisdiction over this case. This Motion is supported by the accompanying Memorandum of Points and Authorities.

MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

Neither of the two bases Defendants asserted for removing this action to District Court

is valid. First, in order for the Court to have diversity jurisdiction, none of the Defendants may be citizens of the same state as a Plaintiff. As Defendants have admitted, like the Plaintiffs, the Kants are citizens of Arizona. And, as explained in Plaintiffs' Response to the Kants' Motion to Dismiss, which is incorporated herein by reference, there is simply no basis for dismissing the Kants as Defendants in this action. Moreover, the ML Liquidating Trust shares citizenship in New York and Florida with one of the Defendants. Accordingly, there is not diversity of citizenship among all of the parties, which completely negates one of the two bases Defendants asserted for removing this case to this Court.

Second, District Court may exercise jurisdiction over certain types of claims that "relate to" a bankruptcy proceeding. But, claims that exist entirely apart from the bankruptcy proceeding and do not necessarily depend upon resolution of a substantial question of bankruptcy law do not warrant the exercise of the Court's "related to" jurisdiction. Plaintiffs' common law legal malpractice and breach of fiduciary duty claims against Defendants exist regardless of any bankruptcy proceeding and they do not depend upon the resolution of any questions of bankruptcy law. Accordingly, the Court should not exercise "related to" jurisdiction over this action and the case should be forthwith remanded to Maricopa County Superior Court.

II. FACTUAL BACKGROUND

This case involves the unfortunate demise of Mortgages, Ltd.,[1] ("ML") one of Arizona's oldest private real estate lenders. Due to ML's failure, ML and its many investors lost hundreds of millions of dollars. Defendants Greenberg Traurig, LLP ("GT") and Robert Kant ("Kant") were ML's securities counsel during the critical time period that led up to ML's collapse. ML engaged Defendants as its securities counsel in 2006. Complaint at ¶ 45. Approximately two years and hundreds of millions of dollars of debt later, ML's primary

[1] As part of its Chapter 11 Plan, Mortgages, Ltd. changed its name to ML Servicing Co., Inc.

business operations had ceased and it was forced into an involuntary bankruptcy proceeding. *Id*. at ¶ 161.

GT and Kant prepared at least 11 Offering Memoranda for ML to use in connection with its efforts to procure funds from investors. *Id*. at ¶ 50. But, those Offering Memoranda included completely inaccurate disclosures that included blatant material misrepresentations and glaring omissions of material facts that were known by the Defendants and would have, if properly disclosed, caused investors to shun rather than embrace ML. *Id*. at ¶¶ 164-75.

In addition to preparing Offering Memoranda that violated applicable securities laws, GT and Kant also failed to advise ML to stop taking money from Radical Bunny, LLC ("Radical Bunny"), a company that raised money exclusively for ML through the unlawful sale of unregistered securities even though they knew that by doing so, ML was putting itself and its investors in grave danger. *Id*. at ¶¶ 93, 96. Defendants' malpractice and fiduciary duty breaches were compounded by an effort to conceal their misconduct through their recommendation that ML terminate an employee who tried to raise concerns about the lack of adequate disclosures that were being sent to ML's investors. *Id*. at ¶¶ 143-50, 154. Ultimately, ML, its investors and its creditors lost hundreds of millions of dollars, with Defendants being among the few who profited during ML's collapse.

With ML's failure imminent, in June 2008, ML's CEO Scott Coles committed suicide. Shortly thereafter, some of ML's creditors forced ML into an involuntary bankruptcy proceeding. *Id*. at ¶ 161. GT continued to represent ML during ML's bankruptcy proceeding and in its Second Interim and Final Amended Application for Allowance and Payment of Fees, which was filed on June 12, 2009, GT sought over $423,000 in attorneys' fees for work that it performed for ML during the pendency of ML's bankruptcy case.

Over two years ago, on May 20, 2009, ML's Chapter 11 Plan for reorganization was

confirmed by the Bankruptcy Court.[2] ML is therefore now in the post-confirmation stages of its Plan. Among other things, the Plan allows the pursuit of claims against professionals including the Defendants who caused ML's insolvency to deepen during its final years of existence. Section 6.2 of ML's confirmed Plan states, "The Liquidating Trust shall have the full power and authority, either in its name or the Debtor's name, to commence, prosecute, settle and abandon any action related to the Avoidance Actions and Causes of Action and/or object to Claims." *See* Exhibit A. The claims asserted in this action fall within the broad definition of "Cause of Action" under the Plan. Accordingly, because the Plaintiffs have been authorized by the Bankruptcy Court to prosecute, settle, or abandon ML's claims against the Defendants, this action will proceed completely independent of the Bankruptcy Court.

Several months after ML's Plan was confirmed by the Bankruptcy Court, on January 19, 2010, the Securities and Exchange Commission ("SEC") entered an Order Instituting Administrative Proceedings Pursuant to § 15(b) of the Securities Exchange Act of 1934, Making Findings, and Revoking Broker-Dealer Registration against ML ("SEC Order"). Complaint at ¶ 183. In the SEC Order, the SEC specifically criticized the lack of disclosures in the Offering Memoranda that had been prepared by Defendants. In the SEC Order, the SEC found that ML and MLS violated § 17(a) of the Securities Act of 1933 and § 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities. *Id*. at ¶ 184. Those violations of securities laws were directly and proximately caused by the legal advice that was given to ML by GT and Kant. *Id*. at ¶ 185. Indeed, if GT and Kant had not written Offering Memoranda that included material misrepresentations and omissions of material facts, fewer investors would have invested in ML through those private offerings. *Id*. at ¶

[2] The Court may take judicial notice of ML's confirmed Plan of Reorganization and all other filings in ML's bankruptcy case. *Lee v. City of Los Angeles*, 250 F.3d 668 (9th Cir. 2001). For the Court's convenience, a copy of the Plan is attached as Exhibit A.

177. Moreover, if GT and Kant had correctly and competently performed all of the duties that they owed to ML, ML would have stopped doing business or significantly changed the way it was doing business in 2006 when GT and Kant first starting representing ML and that would have prevented ML from substantially deepening its insolvency between 2006 and 2008. *Id*. at ¶ 220.

The SEC Order made it evident that Kant and GT had breached their duties to ML and failed to provide correct and complete legal advice regarding ML's securities. Thereafter, on April 16, 2010, at GT's request, ML and GT entered into a Tolling Agreement. *Id*. at ¶ 14. A copy of the Tolling Agreement is attached as Exhibit B. GT signed the Tolling Agreement on behalf of itself and its "affiliates," which includes Kant. *See* Exhibit B.

Plaintiffs commenced this action in Maricopa County Superior Court on March 25, 2011. In their Complaint, Plaintiffs asserted two Arizona common law causes of action against Defendants for: 1) legal malpractice; and 2) breach of fiduciary duty. Thereafter, Defendants removed the case to this Court. After the case was removed, GT filed an Answer and the Kants filed a Motion to Dismiss.

III. THE CASE SHOULD BE REMANDED TO SUPERIOR COURT.

A. Removal is Disfavored.

When Defendants removed this case, they argued that: 1) the Kants were fraudulently joined and therefore the Court could exercise diversity jurisdiction over the case; and 2) because ML is a debtor in the post-confirmation phase of a bankruptcy proceeding, the Court should exercise jurisdiction over this case because the claims are "related to" the bankruptcy. Neither argument is meritorious. Federal jurisdiction must be rejected if there is ***any*** doubt as to the right of removal. *Gaus v. Miles*, 980 F.2d 564, 566 (9th Cir. 1992). "The strong presumption against removal jurisdiction means that the defendant always has the burden of establishing that removal is proper." *Id.* And, the removal statute is strictly construed ***against***

removal jurisdiction. *Prize Frize Inc. v. Matrix*, 167 F.3d 1261, 1265 (9th Cir. 1999). The Court should focus on those basic principles in connection with its determination of whether this Court may exercise jurisdiction over this action.

B. The Kants Were Not Fraudulently Joined as Defendants.

Defendants' contention that the Kants were fraudulently joined is utterly baseless. Kant is the main attorney at GT who was responsible for advising ML with regard to securities matters. He is also the principal attorney who drafted the Offering Memoranda that were replete with factual misrepresentations and omissions of material facts.

The joinder of a resident defendant is fraudulent only when the plaintiff fails to state a cause of action against a resident defendant and the failure is obvious according to the settled rules of the state. *Ritchey v. Upjohn Drug Co.*, 139 F.3d 1313, 1318 (9th Cir. 1998). Claims of fraudulent joinder must be proven by clear and convincing evidence. *Bertrand v. Aventis Pasteur Laboratories, Inc.*, 226 F.Supp.2d 1206, 1212 (D.Ariz. 2002). All uncertainties of law and factual allegations must be resolved in favor of the plaintiff and against the defendant. *Id.* To prove fraudulent joinder, the removing party must demonstrate that there is no possibility that the plaintiff would be able to establish a cause of action against the in-state defendant in the state court case. *Hartley v. CSX Transp. Inc.*, 187 F.3d 422, 424 (4th Cir. 1999). The party alleging fraudulent joinder bears a heavy burden and must show that the plaintiff cannot establish a claim even after resolving all issues of law and fact in the plaintiffs' favor. *Id.* This standard is even more favorable to the plaintiff than the standard for motions to dismiss. *Id.* Thus, in order for the Court to determine that is has diversity jurisdiction over this matter, Defendants must prove, after resolving all issues of fact and law in favor of Plaintiffs, that there is clear and convincing evidence that the statute of limitations on Plaintiffs' claims against Kant expired prior to the commencement of this action. Defendants have not and simply cannot meet that hefty burden at this stage.

As explained in Plaintiffs' Response to the Kants' Motion to Dismiss, which is incorporated herein by reference, there is no basis to dismiss Plaintiffs' claims against Kant. A cause of action for legal malpractice accrues when a plaintiff: (1) has sustained actual and appreciable non-speculative harm or damage as a result of malpractice; ***and*** (2) knows or in the exercise of reasonable diligence should know that the harm or damages was a direct result of an attorney's negligence. *Commercial Union Ins. v. Lewis and Roca*, 183 Ariz. 250, 252-253, 902 P.2d 1354, 1356-57 (App. 1995). Determinations of the point in time when discovery occurs and a cause of action accrues are "usually and necessarily ***questions of fact for the jury***." *Walk v. Ring*, 202 Ariz. 310, 316, 44 P.3d 990, 996 (2002) (emphasis added); *see also Cannon v. Hirsch Law Office PC*, 222 Ariz. 171, 182, 213 P.3d 320, 331 (App. 2009).

Defendants have provided the Court with nothing more than conjecture about when ML knew or reasonably should have known that it had viable claims against Kant. And, the dates on which they are seeking to attribute such knowledge make no sense. Defendants have taken the position that ML knew of its claims against Kant on the date on which ML was forced into an involuntary bankruptcy proceeding or shortly thereafter when one of ML's creditors filed a document that stated, "***To the extent*** that any improprieties tainted these private offerings [that Kant drafted], [ML's] estate may possess claims against Greenberg for its work associated with the same." (emphasis added). There is no evidence that ML knew or should have known that it had claims against Kant at either juncture.

Being forced into bankruptcy does not automatically cause enlightenment about the existence of viable legal malpractice claims against securities counsel. While ML knew it had been harmed by something or some combination of things, it certainly did not know who had harmed it or how it had been harmed when it was abruptly forced into bankruptcy. And, knowledge of harm is itself insufficient for the statute of limitations to begin running without

reason to connect the harm to a particular cause in such a way that a reasonable person would be on notice to investigate whether the injury might be a result of someone's fault. *Walk*, 202 Ariz. at 316, 44 P.3d at 996. That is particularly true given that GT continued to represent ML in connection with that bankruptcy proceeding through May 2009. Because the time of discovery of a cause of action is an issue of fact and all factual issues must be resolved in favor of Plaintiffs at this stage, absent concrete evidence to the contrary, the Court must assume that ML's claims are not barred by the statute of limitations. Accordingly, the Court should remand the case because the Kants and Plaintiffs each reside in Arizona.

C. The Citizenship of the Beneficiaries of the ML Liquidating Trust Preclude Diversity Jurisdiction.

Even if the Kants were not proper parties, this Court would still be precluded from exercising diversity jurisdiction over the case because the ML Liquidating Trust is a citizen of New York and Florida – the very same states where GT claims to be a citizen. *See* Exhibit B, Affidavit of Matthew Hartley. When an action is brought by an artificial unincorporated entity like a trust, "diversity of citizenship depends upon the citizenship of all the members." *Carden v. Arkoma*, 494 U.S. 185, 195 (1990). Indeed, the citizenship of both the trustee and all of the beneficiaries of the trust must be considered when determining the citizenship of a trust. *Emerald Investors Trust v. Gaunt Parsippany Partners*, 492 F.3d 192, 205 (3rd Cir. 2007). In their Notice of Removal, Defendants cited *Johnson v. Columbia Properties, LP*, 437 F.3d 894 (9th Cir. 2006) for the proposition that a trust has the citizenship of its trustee. They then leap to the conclusion that only the citizenship of the Trustee of the ML Liquidating Trust need be considered when determining in which states the ML Liquidating Trust is a citizen. However, *Johnson* does ***not*** stand for that proposition. Nor could it in light of the holding in *Carden*.

Indeed, Defendants' position and similar reliance on the holding in the *Johnson* case

have been squarely rejected by at least one district court within the Ninth Circuit. *See e.g. PDP La Mesa LLC v. LaSalle Medical Office Fund II*, 2010 WL 3988598 (Slip Copy) (S.D.Cal. 2010). Many other courts have also rejected Defendants' position and held that the citizenship of the beneficiaries of a trust must be considered for purposes of determining whether diversity jurisdiction is proper. *See e.g. Riley v. Merrill Lynch*, 292 F.3d 1334, 1337 (11th Cir. 2002); *San Juan Basin Royalty Trust v. Burlington Resources Oil & Gas Co.*, 588 F.Supp. 1274, 1280 (D.N.M. 2008); *In re A.H Robins Co., Inc*. 197 B.R. 519 (E.D.Va.1994). Because ML Liquidating Trust has beneficiaries who are citizens of New York and Florida, there is no diversity of citizenship between Plaintiffs and all of the Defendants. Accordingly, the Court may not assert jurisdiction over this case on the grounds that there is diversity of citizenship.

D. The Court Should Not Exercise "Related to" Jurisdiction Over this Case.

Bankruptcy "related to" jurisdiction is not limitless. *Celotex Corp. v. Edwards*, 514 U.S. 300, 308 (1995). And, post-confirmation "related to" jurisdiction is significantly more limited than pre-confirmation jurisdiction. *In re Pegasus Gold*, 394 F.3d 1189, 1194 (9th Cir. 2005). The Ninth Circuit Court of Appeals has adopted the "close nexus" test for determining the scope of "related to" jurisdiction in the post-confirmation context. *Vacation Village v. Clark County*, 497 F.3d 902, 911 (9th Cir. 2007). Under this test, jurisdiction only exists over claims which have a close nexus to the bankruptcy plan or proceeding. *Pegasus*, 394 F.3d at 1194. To satisfy the close nexus test, the claim must affect an integral aspect of the bankruptcy process. *In re Resorts Int'l, Inc.*, 372 F.3d 154, 167 (3rd Cir. 2004).

Post-confirmation claims that exist entirely apart from the bankruptcy proceeding and do not necessarily depend upon resolution of a substantial question of bankruptcy law are claims which do not satisfy the close nexus test for purposes of establishing "related to" jurisdiction. *In re Ray*, 624 F.3d 1124, 1135 (9th Cir. 2010); *In re Harris*, 44 F.3d 1431,

1435-38 (9th Cir. 1995). Only "matters affecting the interpretation, implementation, consummation, execution, or administration of the confirmed plan will typically have the requisite close nexus." *In Re Pegasus Gold*, 394 F.3d at 1194. In general, courts have found a close nexus only when the claims involve construction or interpretation of the plan or an important component of the plan or otherwise involve the confirmation order. *Id.*

Plaintiffs' claims in this action do not have a close nexus to any bankruptcy plan or proceeding. The claims would exist regardless of whether ML had been a debtor in a voluntary or involuntary bankruptcy proceeding. Moreover, Plaintiffs' legal malpractice and breach of fiduciary duty claims do not in any way depend on the resolution of any questions of bankruptcy law. They are common law claims that are not in any way dependent on the existence of any bankruptcy proceeding.

In *In re Resorts* the Third Circuit applied the close nexus test and resolved a virtually identical jurisdictional dispute. In that case, after the debtor's reorganization plan had been confirmed, the liquidating trust that was created by that plan asserted claims against an accounting firm for breach of contract and malpractice. *In re Resorts*, 372 F.3d at 157. The trustee sought to pursue those claims in bankruptcy court. The trustee argued that even though the plan had already been confirmed, the bankruptcy court could exercise "related to" jurisdiction over the claims because the bankruptcy estate would be affected by the malpractice suit and any recovery obtained would be available for possible distribution to the former creditors of the debtor's estate. *Id.* The accounting firm challenged the bankruptcy court's jurisdiction over the dispute, which arose from state common law claims. On appeal, the Third Circuit ruled that the claims against the accounting firm did not have a close nexus to the bankruptcy plan or proceeding and therefore the bankruptcy court lacked jurisdiction over those claims. *Id.* at 170.

The procedural posture and arguments in *In re Resorts* are very similar to those that have been asserted in this case. Both cases involve assertion of common law malpractice claims after a plan of reorganization has been confirmed. Each case also involves misguided arguments that bankruptcy "related to" jurisdiction applies to those claims. The outcome in this case should be no different from the ultimate result in *In re Resorts* – the arguments that there is "related to" jurisdiction should be rejected. Similar results have been reached in other cases involving state law common law claims that parties have sought to pursue claims in federal courts on the grounds that the claims are "related to" a bankruptcy proceeding. *See e.g. In re Ray*, 624 F.3d 1124 (holding that a common law breach of contract claim asserted against a debtor after the debtor had confirmed a plan of reorganization did not give rise to "related to" jurisdiction even though the contract related to the sale of real property by the debtor before his bankruptcy plan was confirmed).

Tellingly, in their Notice of Removal, Defendants have stated that they do not consent to any final orders or judgments by the Bankruptcy Court. Even though Defendants are relying on bankruptcy "related to" jurisdiction, they have no interest in having any of the claims against them litigated in Bankruptcy Court. In other words, Defendants are trying to take advantage of a jurisdictional statute that is designed to enable Bankruptcy Courts to assume jurisdiction over claims that are related to matters that are properly before them, but simultaneously refusing to allow the Bankruptcy Court to adjudicate those claims. It is therefore evident that Defendants are simply trying to forum shop rather than seeking to have this case resolved before the proper court. Because there is no close nexus between Plaintiffs' claims and ML's bankruptcy, the Court should remand this case.

E. The Court Should Also Remand the Case on Equitable Grounds.

In addition to remanding this case due to the lack of diversity and "related to" jurisdiction, the Court should also remand this on equitable grounds. 28 U.S.C. § 1452(b)

provides: "The court to which such claim or cause of action is removed may remand such claim or cause of action on ***any*** equitable ground." (emphasis added). The authority granted by that statute "is an unusually broad grant of authority. It subsumes and reaches beyond all of the reasons for remand under non-bankruptcy removal statutes." *In re McCarthy*, 230 B.R. 414, 417 (9th Cir. 1999). The purpose of § 1452(b) is to enlarge a trial court's power to remand a claim related to a bankruptcy case. *Security Farms v. Int'l Broth. of Teamsters, Chauffeurs*, 124 F.3d 999, 1010 (9th Cir. 1997).

When considering whether to remand a case under this statute, courts consider a myriad of factors. *See In re Cedar Funding, Inc.*, 419 B.R. 807, 820 (9th Cir. BAP 2009). Courts may exercise their equitable remand powers under 28 U.S.C. § 1452(b) even in cases where an action is also removed on diversity or federal question grounds. *See In re Cytodyn of New Mexico, Inc.*, 374 B.R. 733, 738 (Bankr. C.D. Cal. 2007). The same rule applies to cases removed under "related to" jurisdictional grounds. *Davis v. Life Investors Ins. Co. of America*, 282 B.R. 186, 187-88, 194 (S.D. Miss. 2002). Multiple reasons warrant the remanding of this case on equitable grounds. First, there are no bankruptcy issues to be decided in this case. Plaintiffs' claims are state law common law claims. Second, as previously explained, the claims in this action do not relate to ML's bankruptcy proceeding. The claims are entirely independent of that proceeding and could have been asserted regardless of whether the bankruptcy proceeding had been commenced. Each of those factors is an independent basis for remanding the case on equitable grounds. *See Cedar Funding*, 419 B.R. at 820.

IV. CONCLUSION

There is no diversity of citizenship in this case. The Kants are Arizona citizens and there is no basis for dismissing them from this case. Moreover, because the ML Liquidating

Trust is considered a citizen of New York and Florida by virtue of it having beneficiaries who reside in those states as well as Arizona, there is no diversity of citizenship among the parties.

Furthermore, Plaintiffs' common law legal malpractice and breach of fiduciary duty claims against Defendants exist regardless of any bankruptcy proceeding and they do not depend upon the resolution of any questions of bankruptcy law. Accordingly, the Court does not have "related to" jurisdiction over this action. Because this Court lacks jurisdiction, Plaintiffs respectfully request that the Court forthwith remand this action to Maricopa County Superior Court.

RESPECTFULLY SUBMITTED this 26th day of May, 2011.

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I hereby certify that on the 26th day of May, 2011, I caused the foregoing document to be filed electronically with the Clerk of Court through ECF; and that ECF will send an e-notice of the electronic filing to the following ECF participants:

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