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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 **RESPONSE TO MOTION TO DISMISS** (Assigned to the Honorable David G. Campbell) (Oral Argument Requested)

Pursuant to Rule 12 of the Federal Rules of Civil Procedure, Plaintiffs hereby submit their Response in opposition to the Motion to Dismiss ("Motion") that was filed by Defendants Robert and Ellen Kant ("Kant") and respectfully request that the Motion be denied. Plaintiffs object to the removal of this action to this Court and they will soon file a separate Motion to remand the case to Maricopa County Superior Court in which they will explain in detail the reasons why the case should be remanded, but the arguments set forth herein support Plaintiffs'

position that this case should be remanded. Accordingly, the filing of this Response should not be construed as an agreement by Plaintiffs that jurisdiction over this action is proper in this Court. This Response is supported by the accompanying Memorandum of Points and Authorities.

MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

A claim may be dismissed under Rule 12(b)(6) on the grounds that it is time barred by the statute of limitations ***only if*** the moving party can demonstrate ***beyond doubt*** that it is apparent from the face of the Complaint that the plaintiff can prove no set of facts that would establish the timeliness of the claim. The only things that are evident from the face of Plaintiffs' Complaint that pertain to its timeliness are: 1) Plaintiffs did not and could not have discovered that any damage caused by Kant's malpractice and his breaches of his fiduciary duties until ***sometime after*** Plaintiff ML Servicing Co., Inc. ("ML") was involuntarily forced into bankruptcy in June 2008; 2) in January 2010, the SEC determined that ML violated securities laws by among other things, issuing deficient Offering Memoranda that had been authored by Kant; and 3) the parties signed a tolling agreement in April 2010. Complaint at ¶¶ 14, 183, 200. With no evidence or allegations in the Complaint to support his position, Kant asks the Court to arbitrarily attribute the date of the commencement of ML's bankruptcy as the date on which Plaintiffs must have known that Kant committed legal malpractice and breached his fiduciary duties to ML. And, he makes that request despite the fact that his firm continued to represent ML throughout ML's bankruptcy case for nearly a full year beyond that date. Because Kant has not and cannot meet his burden of demonstrating beyond doubt that Plaintiffs can prove no set of facts that would establish the timeliness of their claims, the Court should deny Kant's Motion.

II. FACTUAL BACKGROUND

This case involves the unfortunate demise of Mortgages, Ltd.,[1] one of Arizona's oldest private real estate lenders. Due to ML's collapse, ML and its many investors lost hundreds of millions of dollars. While there were various factors that contributed to ML's ultimate demise, Kant's improper acts and omissions caused ML's insolvency to deepen dramatically between 2006 and 2008. As a result of Kant's acts and omissions, ML continued doing business for two years longer than it otherwise would have and in that time period, it amassed tens of millions of dollars in liabilities in excess of the total amount of liabilities it already had before Kant became ML's lawyer. Kant's malpractice and fiduciary duty breaches were compounded by an effort to conceal his misconduct through Kant's firm's recommendation that ML terminate a whistleblower who tried to raise concerns about the lack of adequate disclosures that were being sent to ML's investors. Ultimately, ML, its investors and its creditors lost hundreds of millions of dollars, with Kant and his firm being among the few who profited during ML's collapse.

A. ML Retained Kant to Provide Securities Advice.

Kant and his firm Greenberg Traurig, LLP ("GT") began representing ML in 2006. Complaint at ¶ 45. Kant is a highly experienced securities lawyer. ML hired Kant and GT to provide ML legal advice concerning ML's sales of securities and to prepare Offering Memoranda that would be used by ML to raise funds from investors. *Id.* at ¶ 46. From 2006 through the filing of ML's bankruptcy, GT and Kant authored at least 11 Private Offering Memoranda for ML that were used to solicit investments from the public. *Id*. at ¶ 50. ML reasonably expected that Kant would provide ML with accurate and complete legal advice to ensure that ML was complying with all applicable securities laws. *Id*. at ¶ 47.

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

B. Kant Knew that ML's Primary Source of Capital was Coming From the Unlawful Sale of Securities.

When Kant became ML's counsel, ML was already heavily dependent on Radical Bunny, LLC ("Radical Bunny") as its primary source of capital. *Id*. at ¶¶ 30, 57. Radical Bunny raised the money that it loaned to ML through the unlawful sale of unregistered securities. *Id*. at ¶ 32. Kant knew about the relationship between ML and Radical Bunny and he was well aware of Radical Bunny's illegal practices before he authored Offering Memoranda for ML. *Id*. at ¶ 57. In fact, in late 2006 or early 2007, Kant met with Radical Bunny's principal Tom Hirsch ("Hirsch") for the purpose of discussing Radical Bunny's securities practices. *Id*. at ¶¶ 63, 66. During that meeting, Kant stated that he expected to see Hirsch's picture on the front page of the *Arizona Republic* one day because of Radical Bunny's violations of numerous securities laws and that Kant did not want to see ML's CEO, Scott Coles' picture next to him. *Id*. at ¶ 74. In a subsequent meeting that took place several months later, Kant told Hirsch, "they put people in jail for this [type of illegal sales of securities]" and/or "some day you're going to go to jail for this if you don't stop." *Id*. at ¶ 118.

Once Kant learned that ML was receiving illegally raised funds, he knew that ML could be implicated as a co-conspirator in Radical Bunny's illegal scheme. *Id*. at ¶¶76-78. But, he also realized that without funding from Radical Bunny, ML would be unable to pay the hefty fees that Kant and his firm were charging ML and planned to keep billing going forward. *Id*. at ¶¶ 139-41, 194-95. He also knew that ML's involvement with Radical Bunny along with other serious problems that ML was experiencing should be disclosed to ML's existing and potential new investors. *Id*. at ¶ 104. Pursuant to Rules ER 1.2 and 1.16 of the Arizona Rules of Professional Conduct for attorneys, once Kant knew that ML had received and was receiving funds from Radical Bunny, which had been raised illegally, Kant had two ethical options: disclose those facts and the risks associated therewith in Offering

Memoranda that were sent to ML's prospective investors or withdraw as ML's counsel. *Id*. at ¶ 89. He did neither.

C. Kant Drafted Offering Memoranda that Failed to Disclose ML's Relationship With Radical Bunny and the Associated Risks Therewith.

Despite knowing that ML's primary source of capital was generated through Radical Bunny's unlawful sale of securities, Kant did not advise ML to stop taking ill-gotten funds from Radical Bunny. *Id*. at ¶¶ 93, 96. Instead, he proceeded to author additional Offering Memoranda for ML that failed to disclose that ML's primary source of capital came from the unlawful sale of securities and other significant risks to ML's investors. *Id*. at ¶¶ 97-104. In total, GT and Kant prepared at least 11 Offering Memoranda for ML. *Id*. at ¶ 162.

The disclosures in each of the Offering Memoranda that GT and Kant prepared for ML included approximately 12 pages of virtually identical disclosures but those disclosures were broad and general and deliberately did not disclose or address the serious risks that GT and Kant knew about when they prepared those Offering Memoranda. *Id*. at ¶¶ 178-79. Each of the Offering Memoranda that GT and Kant prepared for ML included, among others, the following misrepresentations: 1) ML's securities were exempt from registration under the federal securities laws provided by Regulation D of the Securities Act of 1933; 2) the investments were only being sold to accredited investors; and 3) ML expected to satisfy redemption requests promptly even though by no later than 2007, GT and Kant knew or reasonably should have known that ML lacked the ability to do so. *Id*. at ¶¶ 164-66. Each of the Offering Memoranda that GT and Kant prepared for ML also excluded numerous important material omissions. *Id*. at ¶¶ 168-75.

Incredibly, despite an inherent and blatantly obvious conflict of interest, well-after Kant knew about Radical Bunny's unlawful practices, at ML's expense, he drafted two offering memoranda for Radical Bunny. *Id*. at ¶¶ 128-34. Like the Offering Memoranda he

had drafted for ML, the ones he authored for Radical Bunny also failed to disclose Radical Bunny's unlawful sale of unregistered securities and other serious risks that should have been disclosed to investors. *Id*. at ¶¶135-37. He did that because he knew that without Radical Bunny continuing to provide capital to ML, ML would be unable to stay in business and continuing paying GT's legal bills. *Id*. at ¶¶138-41.

D. GT Took Steps to Conceal Its Malfeasance.

To make matters worse, Kant and GT took affirmative steps to cover up their malfeasance. In March 2008, an ML employee began questioning the lack of disclosures in the Offering Memoranda that were prepared by Kant. *Id*. at ¶ 143. Kant and GT reassured ML that ML was complying with all applicable securities laws and promptly took steps to silence the whistleblower by advising ML to terminate him. *Id*. at ¶¶ 147-50. Kant's firm then prepared a U-5 form, which was required because of the employee's position with ML, and falsely stated in that U-5 form that the employee's termination was caused by his failure to provide specific information about operational and legal issues that he had raised and because ML had purportedly discovered that he was not "well suited to continue working for [ML]" and that he had misrepresented his credentials to ML. *Id*. at ¶ 154.

E. GT Continued to Represent ML After ML's Bankruptcy Commenced.

In June 2008, ML's CEO Scott Coles committed suicide. Shortly thereafter, ML's creditors forced ML into an involuntary bankruptcy proceeding. *Id*. at ¶ 161. The combination of Coles' suicide and the involuntary bankruptcy created great turmoil and confusion for ML. But, GT continued to represent ML throughout that tumultuous period and during ML's bankruptcy proceeding. In fact, in GT's 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. The Court may take judicial notice of that and a myriad

of additional filings by GT in ML's bankruptcy case. *Lee v. City of Los Angeles*, 250 F.3d 668 (9th Cir. 2001). ML's reorganization Plan, which among other things, gave ML Liquidating Trust the authority to pursue certain claims, including the claims asserted in this action, was confirmed on May 20, 2009.

F. The SEC Determined that ML Violated Securities Laws.

On January 19, 2010, the Securities and Exchange Commission ("SEC") entered an Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Revoking Broker-Dealer Registration against MLS ("SEC Order"). *Id*. at ¶ 183. In the SEC Order, the SEC specifically criticized the lack of disclosures in the Offering Memoranda that had been prepared by Kant. Prior to the issuance of the SEC Order, GT and Kant had represented to ML that ML had not violated any securities laws. Because ML trusted its counsel, it had no reason to doubt the veracity of those assurances. In the SEC Order, the SEC found that ML and MLS violated Section 17(a) of the Securities Act of 1933 and Section 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.

Of course, 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 ¶ 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 A.[2] GT signed the Tolling Agreement on behalf of itself and its "affiliates," which includes Kant. *See* Exhibit A.

III. DISMISSAL OF KANT IS NOT WARRANTED.

Motions to dismiss for failure to state a claim are generally disfavored and rarely granted. *Gilligan v. Jamco Development Corp*., 108 F.3f 246, 249 (9th Cir. 1997). When considering a motion to dismiss, the Court must accept all of the Plaintiffs' allegations as true and draw all reasonable inferences in Plaintiffs' favor. *Wyler Summit Partnership v. Turner Broadcasting Sys. Inc*., 135 F.3d 658, 661 (9th Cir. 1998). The purpose of a motion to dismiss filed pursuant to Rule 12(b)(6) is to test the formal sufficiency of the statement of the claim for relief in the complaint. *Rutman Wine Co. v. E. & J. Gallo Winery*, 829 F.2d 729, 738 (9th Cir. 1987). It is not a procedure for resolving a contest about the facts or the merits of the case. In reviewing the sufficiency of the complaint, the issue is not whether the plaintiff will ultimately prevail but whether the plaintiff is entitled to offer evidence to support the claims asserted. *Scheuer v. Rhodes*, 416 U.S. 232, 236, 94 S.Ct. 1683, 40 L.Ed.2d 90 (1974). Motions to dismiss based upon statutes of limitations may be granted ***only if*** the assertions of the complaint, read with the required liberality, demonstrate ***beyond doubt*** that the plaintiff can prove no set of facts that would establish the timeliness of the claim. *Supermail Cargo, Inc. v. United States*, 68 F.3d 1204, 1206-7 (9th Cir. 1995). In the absence of evidence on the face of the complaint that the applicable limitations period expired before the complaint was

[2] The Court may consider documents that are referenced in the Complaint without converting Kant's Motion to a Motion for Summary Judgment. *Parrino v. FHP, Inc.*, 146 F.3d 699, 706 (9th Cir. 1998); *Anderson v, Clow*, 82 F.3d 1480, 1487, n.4 (9th Cir, 1996).

filed, the Court should deny such motions to dismiss. *Vaughan v. Grijalva*, 927 F.2d 476, 481 (9th Cir. 1991).

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). Harm is actual and appreciable when it becomes irremediable. *Id.* at 254, 902 P.2d at 1358. It is not enough that the plaintiff understand what harm has been done – there must be 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 v. Ring*, 202 Ariz. 310, 316, 44 P.3d 990, 996 (2002). And, the statute of limitations does not accrue based on information believed by the plaintiff to be false or unbelievable. *Id.* Accordingly, 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***." (emphasis added) *Id.* *See also Cannon v. Hirsch Law Office PC*, 222 Ariz. 171, 182, 213 P.3d 320, 331 (App. 2009) (holding that the "discovery issue itself involves questions of reasonableness and knowledge, matter which this court is particularly wary of deciding as a matter of law").

A. The Statutes of Limitations Did Not Begin to Run When ML Was Forced Into Bankruptcy.

Kant argues that ML's claims against him accrued either when ML's bankruptcy proceeding began or by June 27, 2008, when one of ML's creditors who was responsible for forcing ML into an involuntary bankruptcy proceeding, filed a brief 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).

Kant's argument fails for a number of reasons. First, Kant is simply speculating about when ML knew that it had viable claims against him. At this stage in the case, the Court must construe all facts and inferences in ML's favor. *Wyler*, 135 F.3d at 661. The point at which ML had such knowledge is an issue of fact. *Walk*, 202 Ariz. at 316, 44 P.3d at 996. And, Kant has not presented the Court with any facts definitively supporting the notion that ML knew or reasonably could have known that it had viable claims against him in June 2008.

Second, contrary to Kant's position, while ML knew that it was in serious financial trouble when it was forced into bankruptcy, such knowledge does not equate to notice, much less knowledge that Kant had done anything wrong or that ML had been damaged by Kant's conduct. Being put into bankruptcy does not automatically lead to 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 its bankruptcy it was abruptly forced into. And, knowledge of harm is itself insufficient for the statute of limitations to begin running. *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.

If ML knew or reasonably suspected that Kant and GT's actions had caused ML to substantially deepen its insolvency by tens of millions of dollars, ML would not have continued to allow GT to represent ML throughout ML's bankruptcy case over the objections of ML's creditors. In fact, ML had no reason to know that Kant or GT had done anything that caused harm to ML until the SEC Order was entered on January 19, 2010. At that point, it was evident that GT and Kant had not given ML proper advice. It was no coincidence that the parties entered into the Tolling Agreement three months after the SEC Order was issued – that was the point in time when ML knew that Kant and GT's acts and omissions had caused

ML to sustain damages. Accordingly, the statute of limitations on ML's claims against Kant and GT would not have expired until January 19, 2012.

Additionally, the filing by one of ML's creditors, which generically stated that ML could have claims "to the extent that" there were any improprieties with the Offering Memoranda that Kant authored, did not put ML on notice that it could have viable claims against Kant. That document did not specify any problems or claims that anyone knew about. It simply stated that to the extent that any problems were discovered, ML would have a viable claim against GT and Kant. That is akin to saying that to the extent that a seemingly soundly constructed building collapses, the owner of the building may have a claim against those who built it.

And, the context of that filing is significant. The document was filed by an adversary, an ML creditor that was forcing ML into bankruptcy. That fact coupled with GT's continued representation of ML and ML's approval of GT's vigorous resistance to efforts by ML's creditors to remove GT as ML's counsel, demonstrates that ML had no basis to believe that GT had done anything wrong. Even if the creditor's filing did more than make a vague statement about hypothetical rights that ML might have if GT did something wrong, the statute of limitations would not have started running at that point because ML clearly would have believed that information to be false or unbelievable. *Walk*, 202 Ariz. at 316, 44 P.3d at 996 (holding that the statute of limitations does not accrue based on information believed by the plaintiff to be false or unbelievable).

Similarly, the concerns raised by an ML employee about the disclosures in the Offering Memoranda did not cause ML's claims against Kant to accrue. In an effort to conceal their malfeasance, those concerns were quelled by GT and Kant who advised ML that the concerns were without merit and that the employee should be terminated. Complaint at ¶¶ 145, 147-50. Because GT counseled ML that the concerns raised by ML's employee were

without merit and that he was a trouble maker who was unfit for his position at ML, the statute of limitations did not begin to run when the employee expressed his concerns about ML's securities offerings. *Walk*, 202 Ariz. at 316, 44 P.3d at 996.

B. ML's Claims Against Kant Were Tolled.

Even if the Court were to determine that ML's claims against Kant definitively accrued in June 2008, the claims were nevertheless tolled. No one disputes that ML and GT executed a Tolling Agreement in April 2010.[3] *See* Complaint at ¶ 14 and GT's Answer at ¶ 14. GT executed the Tolling Agreement "on behalf of itself and its affiliates" and two of GT's partners who are specifically identified in the Tolling Agreement. *See* Exhibit A at 1. The Tolling Agreement tolled the running of all statutes of limitations on any claims ML had against GT and its affiliates. As a shareholder of GT, Kant is clearly one of GT's affiliates. Accordingly, contrary to Kant's contention, ML's claims against Kant were tolled by the Tolling Agreement.

IV. CONCLUSION

ML did not know that it had viable claims against Kant and GT until the SEC Order was issued in January 2010. At that point, the parties entered into a Tolling Agreement, which tolled ML's claims against GT and Kant. Even if the parties had not executed the Tolling Agreement, ML's claims would have still been timely filed. Kant has not met his hefty burden of showing that the assertions of the Complaint, read with the required liberality, demonstrate ***beyond doubt*** that ML can prove no set of facts that would establish the timeliness of the claims against him. *Supermail*, 68 F.3d at 1206-07. Because he has not presented such evidence, the Court should deny his Motion. *Vaughan*, 927 F.2d at 481.

[3] The Tolling Agreement originally expired on December 31, 2010, but it was extended by further agreement between the parties to the Agreement.

RESPECTFULLY SUBMITTED this 19th day of May, 2011.

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I hereby certify that on the 19th 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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