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IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ARIZONA

ML LIQUIDATING TRUST, as successor-in-interest to Mortgages, Ltd. Plaintiff, vs. MAYER HOFFMAN MCCANN, P.C., a Missouri professional corporation; CBIZ, Inc., a Delaware corporation; CBIZ MHM, LLC, a Delaware limited liability company, Defendants.	Case No. 2:10-cv-02019-MHM

PLAINTIFF'S RESPONSE TO DEFENDANTS' JOINT MOTION TO DISMISS COMPLAINT

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Pages

CASES

TABLE OF AUTHORITIES

STATUTES

OTHER AUTHORITIES

I. INTRODUCTION.

From 2004 to 2007, Defendant Mayer Hoffman McCann, P.C. ("MHM") and its affiliate CBIZ, Inc. ("CBIZ") audited the financial statements of Mortgages Ltd. ("ML"). Year after year, Defendants affirmatively misrepresented to ML, its Board and management that it conducted its audits in accordance with Generally Accepted Auditing Standards ("GAAS") and that ML's financial statements were fairly stated under Generally Accepted Accounting Principles ("GAAP"). As detailed in the Complaint, Defendants' audits were grossly deficient and ML's financial statements were materially misstated. Indeed, just months before ML's bankruptcy, MHM issued a clean opinion on ML's 2007 financial statements without any going concern qualification or disclosure. Over the years, ML reasonably and justifiably relied on MHM's audit reports and audited financial statements with disastrous consequences.

Although the failed audits were nominally conducted in the name of MHM, all of the auditors who performed the audits were employed by CBIZ; MHM has no audit employees. Indeed, MHM's engagement letters specifically state that MHM would be using CBIZ employees in connection with the audits. CBIZ was paid directly for the ML audit services and CBIZ retained the vast majority of the fees paid by ML for the audits. CBIZ also paid the CPAs who performed the audits and shared control over important aspects of the auditors' employment, including compensation and discipline. CBIZ and MHM operate out of the same offices, and their CPAs have CBIZ business cards and email addresses. As CBIZ and MHM effectively operate as one unified business enterprise, both are directly liable to ML for the negligence associated with the ML audits.

It should be noted at the outset that Defendant CBIZ MHM, LLC does not seek dismissal of any of the claims asserted against it. The claims against CBIZ MHM, LLC are, therefore, unaffected by the Motion. MHM and CBIZ, on the other hand, seek partial or full dismissal of the claims asserted against them. For the reasons set forth below, MHM and CBIZ's motion to dismiss should be denied.

II. SUMMARY OF ALLEGED FACTS.

A. The Joint Venture Relationship Between CBIZ, MHM and CBIZ-MHM And CBIZ' Direct Involvement in The ML Audits.

Defendants' relationship with ML indirectly dates back to at least the 1990's at which time ML was being audited by a local accounting firm Miller Wagner & Company Ltd. (Complaint ¶ 20.)

In 1999, Defendant CBIZ and MHM decided to form CBIZ MHM, LLC ("CBIZ-MHM"). (*Id.* at ¶ 21.) This allowed CBIZ to generate revenue from audit services which CBIZ, as a public company, would be precluded from performing directly. (*Id.* at ¶ 33.) Because CBIZ was a large-scale national consulting firm, the relationship provided MHM with a much larger marketing footprint. (*Id.* at ¶ 22.)

In 2003, the Miller Wagner firm was transitioned into MHM and took on the MHM name as a result of an apparent decision and strategy by CBIZ and MHM to expand the MHM name nationally. (*Id.*)

Defendants CBIZ and MHM marketed themselves as a single entity and, for all intents and purposes, were one and the same. In marketing materials, they referred to themselves as "*one* of the Top Ten accounting providers in the US." (*Id.* at ¶ 21.) MHM touted its "close alignment" and "strategic association" with CBIZ. (*Id.* at ¶ 23.) "In substance, MHM, CBIZ, and CBIZ-MHM operate as one unified business." (*Id.* at ¶ 26.) Among other things, MHM and CBIZ share revenues, and CBIZ and CBIZ-MHM have the right to hire, fire and determine compensation of MHM employees. (*Id.*)

In Phoenix, CBIZ and MHM shared the same offices and the same receptionist. (*Id.* at ¶ 27.) The managing partner of the Phoenix office managed both the CBIZ and MHM lines of business and was a shareholder of both MHM and CBIZ-MHM. (*Id.*) The accountants who performed the ML audits were *CBIZ employees* who had CBIZ business cards and CBIZ email accounts. (*Id.* at ¶ 28.) "CBIZ controlled the expenses and staffing on ML audits, and CBIZ was the only source of compensation for work performed by MHM

personnel on the ML audits." (*Id.*) CBIZ even invoiced ML directly for the work performed in connection with the ML audits. (*Id.* at ¶ 29.)

As alleged, "the level of control that CBIZ and CBIZ-MHM exercise over MHM is demonstrated by the fact that CBIZ receives 85% of MHM's gross revenue. MHM is required to utilize the remaining 15% to pay its operating expenses." (*Id*. at ¶ 30.)

CBIZ's arrangement with CBIZ-MHM and MHM has enabled CBIZ to do indirectly that which CBIZ cannot do directly as a public company -- generate substantial revenues from providing audit and attest services. (*Id.*) In substance, however, CBIZ and CBIZ-MHM exercised at least partial control over MHM and the audit services provided by MHM. (*Id.* at ¶ 31.) With the substantial benefits derived from this control, CBIZ and CBIZ-MHM had the responsibility to ensure that MHM's audits of ML were performed in accordance with professional standards. (*Id.*)

B. <u>Defendants' Wrongful Conduct and Misrepresentations Result In The Deepening of ML's Insolvency.</u>

Defendants were engaged to perform audits of the financial statements of ML and its affiliates for the fiscal years ended 2004 through 2007. (Complaint at ¶ 34.) In engagement letters which were provided to ML, Defendants promised that ML's audits would be conducted in accordance with GAAS, that Defendants would alert ML to any deficiencies in ML's internal controls which were discovered during the audits, and that Defendants would "advise [ML] about appropriate accounting principles and their application." (*Id.* at ¶ 46.) As reflected in Defendants' workpapers, Defendants undertook each of its audits with knowledge that ML would be relying heavily upon Defendants' expertise to ensure that ML's financial statements accurately reflected ML's financial condition under GAAP. (*Id.* at ¶¶ 51-57.)

As alleged, the audits of ML's financial statements for the fiscal years ended 2004 through 2007 violated GAAP and GAAS in numerous material respects. For example, Defendants failed to discharge their "responsibility" to properly evaluate and assess

impairment with regard to hundreds of millions of dollars of "mortgage investments" as required under GAAS (AU § 342) and applicable GAAP accounting pronouncements, including FAS 114. (*Id.* at ¶¶ 61-79.) This resulted in the undetected and undisclosed material misstatement of ML's financial statements, including the material understatement of ML's reserves (and hence the material overstatement of ML's "mortgage investments").

In conducting the ML audits, Defendants also failed to properly assess and consider the considerable off-balance sheet risk relating to ML's serviced loan portfolio (*Id.* at ¶¶ 80-85), failed to require the proper balance sheet classification of ML's assets (*Id*. at ¶¶ 86-92), and failed to require consolidation of ML's financial statements with entities managed by ML (*Id.* at ¶¶ 93-101). Defendants also failed to properly perform a "going concern" analysis during its 1996 audit, a failure which was "critical in view of the [economic] headwinds documented in Defendants' workpapers." (*Id.* at ¶¶ 102-111.)

Notwithstanding each of these audit failures, each year Defendants issued audit reports in which it represented to ML that Defendants had, in fact, performed audits in accordance with GAAS and that ML's financial statements were prepared in conformity with GAAP. (*Id.* at ¶ 115.) Defendants knew or should have known that these representations made at the conclusion of each of its audits were materially false and misleading. (*Id.* at ¶¶ 115-116.) Defendants audits were, in fact, not performed in accordance with GAAS and ML's financial statements were not prepared in accordance with GAAP. (*Id.* at ¶ 117.)

Defendants' audit failures and misrepresentations resulted in the undetected, undisclosed material misstatement of ML's year-end financial statements. (*Id.* at ¶ 40). Defendants' unqualified audit reports left ML's Board and management with a serious misimpression as to ML's true financial condition (*Id.* at ¶¶ 34, 35, 108) and Defendants' wrongful conduct and misrepresentations concealed ML's true financial condition, thereby artificially prolonging its existence and deepening ML's insolvency (*Id.* at ¶¶ 123-126).

III. MHM's MOTION MUST BE DENED IN ITS ENTIRETY.

"A dismissal for failure to state a claim is appropriate only where it appears, beyond

doubt, that the plaintiff can prove no set of facts that would entitle it to relief." *Morley v. Walker*, 175 F.3d 756 (9th Cir. 1999). MHM's motion must be denied.

A. <u>The Court Of Appeals' Decision In The *Standard Chartered* Case Does Not Bar ML's Claim For Accounting Malpractice.</u>

MHM does not attempt to contest the substance of the allegations underlying Plaintiff's well-pled malpractice claim. Instead, MHM seeks dismissal of Plaintiff's malpractice cause of action based upon the brazen mischaracterization of the Arizona Court of Appeals' decision in *Standard Chartered PLC v. Price Waterhouse*, 945 P.2d 317 (Ariz. Ct. App. 1996). Quoting *Standard Chartered*, MHM argues that "Arizona does not recognize 'a claim for auditor negligence separate and distinct from [a] negligent misrepresentation claim.'" (Motion, p. 6-8.) MHM has taken *Standard Chartered* totally out of context and, in doing so, has not been candid with the Court.

The Arizona Supreme Court has confirmed that accountants owe *their clients* "special" professional duties of care which are actionable in tort in the form of a professional malpractice claim. *Barmat v. John and Jane Doe Partners A*-D, 747 P.2d 1218 (Ariz. 1987) ("As a matter of public policy,… accountants, and other professionals owe special duties to their clients, and breaches of those duties are generally recognized as torts.").

The Court of Appeals' decision in *Standard Chartered* did not and could not overrule this Supreme Court precedent. Indeed, the *Standard Chartered* case did not even involve a claim for *accounting malpractice by an audit client*. Rather, the core issue in *Standard Chartered* was the nature and extent of an accountant's liability *to third parties* who, in the course of a transaction, receive and rely upon information prepared by the accountant. Specifically, Union Bank, a subsidiary of Standard Chartered, agreed to acquire California-based United Bank. *Standard Chartered*, 945 P.2d at 324. Pursuant to a merger agreement between Union and United, copies of United's audited financial statements, including the

"unqualified audit reports" prepared by United's auditor, Price Waterhouse ("PW"), were provided to Union.[1] (*Id.*) Union went through with the acquisition, and Standard Chartered (as assignee of Union's claims) brought post-acquisition claims against PW based upon misrepresentations in United's PW-audited financial statements. *Standard Chartered*, 945 P.2d at 325.

PW claimed that it owed no legal duty to Union because it was not in privity with Union. *Standard Chartered*, 945 P.2d at 339-41. The question addressed by the Court was the nature and extent of an auditor's liability for negligence to *third parties*. The Court undertook a lengthy analysis under the Restatement (Second) of Torts § 552, which sets forth the elements of a claim for "negligent misrepresentation." (*Id.*) After holding that an auditor's liability to a third party for negligence is governed by, and limited to, claims under section 552 of the Restatement, the Court reached the ultimate conclusion that Standard Chartered could "not submit a claim for auditor negligence separate and distinct from its negligent misrepresentation claim" under section 552. *Standard Chartered*, 945 P.2d at 342.[2]

Nothing in *Standard Chartered* -- nor any other Arizona decision -- precludes an audit client from asserting a claim for professional malpractice with or without a claim for

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[1] In its decision, the Court in *Standard Chartered* court was careful to point out that Union "was clearly standing at arm's length" from United and PW in the context of the acquisition. *Standard Chartered*, 945 P.2d at 325. In other words, Union was not PW's client.

[2] MHM also cites *Kuehn v. Stanley*, 91 P.3d 346 (Ariz. Ct. App. 2004) in support of its argument. *Keuhn* is also inapposite. In *Kuehn*, the plaintiff sued an appraiser for "negligence" based upon an allegedly inaccurate appraisal that was *prepared on behalf of the bank* and provided to the plaintiff before the close of escrow. *Kuehn*, 91 P.3d at 348. Similar to *Standard Chartered*, the court held that plaintiff's "negligence" claim and the duty owed by the appraiser to plaintiff was appropriately analyzed by the trial court as a claim for negligent misrepresentation under section 552 of the restatement. *Kuehn*, 91 P.3d at 350. Unlike Plaintiff's claim in this case, *Keuhn* did not involve a claim of *malpractice* by a client, but by a third party.

negligent misrepresentation. *See CDT, Inc. v. Addison, Roberts & Ludwig, C.P.A., P.C.*, 7 P.3d 979 (Ariz. App. Div. 2000) (involving various claims against accountant including claim of malpractice and negligent misrepresentation). MHM's argument is meritless and should be rejected.

B. <u>Plaintiff's Breach of Contract Claim Is Predicated Upon Defendants' Failure To Perform In Accordance With Specific Contractual Promises, And Is Therefore Well-Alleged.</u>

After first arguing that MHM did not owe its audit client a professional duty of care (Section A above), MHM then argues -- in perfect contradiction -- that MHM's professional duty of care precludes ML's breach of contract claim. According to MHM, this is because "an auditor's professional duties of care may never serve as valid grounds for a breach of contract claim." (Motion, p. 7) Once again, MHM mischaracterizes Arizona law.

In Arizona, a claim for breach of an express contract against a professional may peacefully co-exist with a professional malpractice claim where "there is a specific promise contained in the contract" and "the claim is premised on the nonperformance of that promise." *Keonjian v. Olcott*, 169 P.3d 927, 931 (Ariz. App. Div. 2007).

Plaintiff's breach of contract claim is not based upon generic promises that Defendants would provide audit services. *C.f. Desilva v. Baker*, 96 P.3d 1084 (Ariz. App. 2004) (cited by Defendants) ("[T]here is no evidence Baker made any specific promise that he breached…"); *Collins v. Miller & Miller, Ltd.*, 943 P.2d 747, 755 (Ariz. App. Div. 1996) ("The only specific promise made in the contract is that the firm will represent the clients in litigation, a promise that Miller fulfilled."). Rather, the engagement letters provided to ML contained the following express, specific promises by Defendants including, among others, the following:

- Defendants would conduct its audits of ML in accordance with GAAS (Complaint, ¶¶ 46, 143);
- That Defendants would perform tests of the documentary evidence supporting the transactions recorded in ML's accounts (*Id.*);

- That Defendants would examine evidence supporting the amounts and disclosures in the financial statements of ML (*Id.*); and
- That Defendants would "advise [ML] about appropriate accounting principles and their application." (*Id.*)

As alleged, "Defendants breached the aforesaid contractual duties they owed to ML by failing to perform in accordance with each of the express promises..." (*Id.* at ¶ 133.) For example, it is clearly alleged that Defendants "failed" to perform a GAAS audit and that "Defendants clearly did not provide ML and its management with the accounting expertise and advice which Defendants promised in their engagement letters." (*Id.* at ¶¶ 50, 77.) Notwithstanding Defendants' promise "to advise ML regarding appropriate accounting principles and their application," Defendants' "trained accountants failed to advise ML's Board and management that consolidation was necessary under GAAP," failed to advise management concerning the appropriate classification of ML's due from related party asset, and failed to require that ML record *any* valuation reserve as required under GAAP. (*See, e.g.,* at ¶¶ 77, 86-92; 100.)

On its face, Plaintiff's Complaint clearly states an actionable claim under Arizona law for breach of contract. Dismissal is inappropriate in view of these well-plead allegations.[3]

[3]All of the cases relied upon by Defendants were resolved on motions for summary judgment. To the extent each of these decisions resulted in dismissal of the breach of contract claim, it was only because the plaintiff had not met its burden of proving that the defendant had failed to perform in accordance with a *specific* contractual provision. *See DeSilva*, 96 P.3d at 1092-93 (granting summary judgment "because there [was] no evidence that Baker made any specific promise that he breached."); *Keonjian*, 169 P.3d at 931 (granting summary judgment because "there [was] no evidence of…nonperformance by Olcott."); *Energex Enterprises, Inc. v. Shughart, Thomson & Kilroy, P.C.* 2006 WL 2401245 (D. Ariz. 2006) (granting summary judgment on the grounds that oral promise to provide "reasonable and necessary legal services is nothing more than a general promise"). Plaintiff's claim based upon Defendants' failure to perform specific contractual promises, is simply different.

C. The Shortened Limitations Period In The 2004 and 2005 Audit Engagement Letters Are Unenforceable And Do Not Abrogate The Discovery Rule In Any Event.

To the extent Plaintiff's claims are predicated upon Defendants' 2004 and 2005 audits, MHM argues that those claims are time-barred. MHM points to the provisions in the 2004 and 2005 form engagement letters which required that claims based on the engagements be brought "within twelve (12) months after performance" of Defendants' services. (Motion, p. 9.) As MHM admits, this provision cuts the two-year limitations period applicable to Plaintiff's malpractice and negligent misrepresentation claims in half, and dramatically shortens the six-year statute of limitation applicable to Plaintiff's breach of contract claim (6 years) under Arizona law. (*Id.*)

1. The Limitations-Shortening Provisions In The 2004 and 2005 Engagement Letters Are Unenforceable As A Matter of Law.

The statute of limitations defense is not favored by Arizona Courts. *Gust, Rosenfeld & Henderson v. Prudential Ins. Co. of America*, 898 P.2d 964, 968 (Ariz. 1995). MHM's argument must be rejected.

Arizona courts view any attempt to contractually shorten a limitations period with suspicion. In *Zuckerman v. Transamerica Ins. Co.*, 650 P.2d 441 (Ariz. 1982), the Arizona Supreme Court addressed such a provision in the context of an insurance policy. The Court was clear that the propriety of such a provision must be viewed on a case-by-case basis taking into account public policy considerations. *Zuckerman*, 650 P.2d at 444 ("The facts of this case lead us to question the wisdom of applying this clause in the circumstances presented here.") This is because "[t]he statutes of limitations are declarations of public policy as well as a private right." *Zuckerman*, 650 P.2d at 445. In evaluating whether a contracting party has waived their rights under a statutorily proscribed limitations period (as MHM argues Plaintiff has), the Court emphasized that it is important to determine "whether the terms and conditions" have been "truly negotiated by the parties," which is an issue of fact. *Zuckerman*, 650 P.2d at 448.

The 2004 and 2005 engagement letters were prepared on "MHM"-captioned letterhead, though as alleged and discussed more fully herein, it is clear that Defendant CBIZ had extensive involvement in the audits. Given that they are virtually identical, it is obvious that these letters were pre-printed forms which were provided to Plaintiff at the beginning of each engagement. There is no evidence that ML ever "bargained" for these terms, which, at a minimum, is an issue of fact that must be explored during discovery.

More importantly, Plaintiffs have not unearthed, nor have Defendants cited, a single Arizona court decision upholding a similar provision in the context of a professional services agreement. The California appellate court decision in *Charnay v. Cobert*, 51 Cal.Rptr.3d 471 (Cal. App. 2 Dist. 2006), however, is instructive. Similar to Arizona, the *Charnay* court noted:

> [A] contractually shortened limitations period has never been recognized outside the context of straightforward transactions in which the triggering event for either a breach of a contract or for the accrual of a right is immediate and obvious. Moreover, *no decision upholding the validity of a contractually shortened limitation period has done so in the context of an action against a professional or skilled expert where breach of a duty is more difficult to detect*. Instead, most reported decisions upholding shortened periods *involve straightforward commercial contracts plus the unambiguous breaches or accrual of rights under those contracts*."

Charnay, 51 Cal.Rptr.3d at 481 (emphasis added).

In *Charnay*, the court ultimately concluded that a provision in legal services agreement which shortened the applicable limitations period was unenforceable. As in *Charnay*, the Court should find that the provisions in MHM's 2004 and 2005 professional services engagement letter which shorten the applicable limitations period unenforceable as a matter of law. This is especially true because strict enforcement of the contractual limitation provision in the manner suggested by Defendants would effectively abrogate the well-established discovery rule and preclude Plaintiff from later asserting a claim not discovered within twelve months of Defendants' 2004 and 2005 audits. This is contrary to public policy. *Charnay*, 51 Cal.Rptr.3d at 481 ("[C]ontractual efforts to eviscerate the delayed

discovery rule are thus void as against public policy."). Enforcement of the limitation-shortening provisions in a complex case involving the breach of an accountant's common law and contractual duties is inequitable and unreasonable as a matter of law. (*Id.*)

2. Questions Of When ML "Discovered" Its Claims Against MHM Involve Issues Of Fact Which Should Not Be Resolved On A Motion To Dismiss.

Even if the Court does not deem the twelve-month limitation-shortening period in the 2004 and 2005 engagement letters unenforceable as a matter of law, Plaintiff's claims based upon the 2004 and 2005 audits still should not be dismissed.

MHM's engagement letters state that claims must be filed "within twelve months after performance" of the audit services. Implied in the agreements is that Plaintiff has actually become aware of the claim within that time frame. The engagement letters are silent, however, as to what happens if the Plaintiff had not yet discovered MHM's wrongdoing and, hence, whether Plaintiff is entitled to the benefit of common law tolling doctrines such as the discovery rule, purposeful concealment or the continuing tort doctrine. The ambiguity created by this silence must be construed against MHM, as the drafting party. *Harris v. Harris*, 991 P.2d 262, 265 (Ariz. App. 1999) ("[A] secondary rule of construction provides that ambiguity is to be strictly construed against the drafting party."). The 1994 and 1995 engagement letters should not be construed to preclude application of common law tolling doctrines, including the discovery rule.

Under Arizona law, claims against accountants are governed by the discovery rule under which "the cause of action accrues when the plaintiff knows, or in the exercise of reasonable diligence should have known, of the defendant's negligent conduct…" *Sato v. Van Denburgh*, 599 P.2d 181, 183 (Ariz. 1979).[4] "When discovery occurs and a cause of action accrues are usually and necessarily questions of fact for the jury." *Doe v. Roe*, 955

[4] The Arizona Supreme Court has held that the discovery rule applies equally to both contract and tort claims. *See Gust, Rosenfeld*, 898 P.2d at 968.

P.2d 951, 961 (Ariz. 1998); *see also Logerquist v. Danforth*, 932 P.2d 281, 287 (Ariz. App. Div. 1996) (discovery rule often "depends on resolution of factual issues" and, thus, not surprisingly, the "determination of a claim's accrual date usually is a question of fact…").

A cause of action will only accrue when the plaintiff discovers "that he or she has been injured" and that the injury is the result of "a particular defendant's negligent conduct." *Lawhon v. L.B.J. Institutional Supply, Inc.*, 765 P.2d 1003, 1007 (Ariz. App. 1988). The rule is designed to protect a plaintiff in those circumstances where a "plaintiff's injury or the conduct causing it is not easily detected by the plaintiff," which is typical in professional malpractice cases. *See, e.g., Walk v. Ring*, 44 P.3d 990, 995-96 (Ariz. 2002) (holding in context of dental malpractice claim that "[a] blamelessly uninformed plaintiff cannot be said to have slept on his rights."); *Morrison v. Acton*, 198 P.2d 590, 596 (Ariz. 1948) (holding in medical malpractice action that "[i]t cannot be said under these facts that the plaintiff-patient should be penalized for failing for even this long period of time to discover the true seat of his troubles.")

Defendants' audit failures and misrepresentations resulted in the undetected, undisclosed material misstatement of in ML's year-end financial statements. (Complaint at ¶ 40.) The unqualified audit reports issued by left ML's Board and management with a serious misimpression as to ML's true financial condition. (*Id.* at ¶¶ 34, 35, 108.) Defendants' wrongful conduct and misrepresentations concealed ML's true financial condition, thereby artificially prolonging its existence and deepening ML's insolvency. (*Id.* at ¶¶ 123-126.)

As discussed in greater detail in Section IV.B. *infra* with respect to CBIZ's claims, the question of when Plaintiff discovered the wrongful conduct arising out of Defendants' 2004 and 2005 audits is an issue of fact. MHM's motion to dismiss claims arising under the 2004 and 2005 audits should be denied.

IV. CBIZ'S MOTION MUST BE DENIED IN ITS ENTIRETY.

CBIZ moves to dismiss on two separate grounds. First, CBIZ contends that the Complaint fails to allege grounds upon which CBIZ may be held liable for the failed audits.

Second, CBIZ claims that the claims against it are time-barred. (Motion, p. 10.) Both arguments should be rejected.

A. Plaintiff Has Adequately Alleged Claims Against CBIZ Under Theories of Primary And Vicarious Liability.

CBIZ contends that the Complaint fails to suggest grounds upon which CBIZ may be held either primarily or vicariously liable. This is false.

1. Plaintiff Has Adequately Alleged Primary Liability Against CBIZ Based Upon CBIZ' Direct Involvement In The ML Audits.

CBIZ' contention that it cannot be held primarily liable for the failed audits is based upon its self-serving conclusion that the engagement letters and auditor's reports (which it attaches to its motion) "prove" that CBIZ did not contract with ML, did not participate in the failed ML audits and that CBIZ "made no statements to ML." (Motion, pp. 10-11.) CBIZ is effectively asking the Court to grant summary judgment based on a handful of documents while ignoring CBIZ's pervasive involvement in the ML audits.

As alleged in the Complaint, all of the accountants who performed the ML audits under MHM's name were *CBIZ employees*. The auditors carried CBIZ business cards and had CBIZ email addresses. (Complaint at ¶ 28.) CBIZ had the power to hire, fire, compensate and discipline the auditors who performed the ML audits -- all functions traditionally performed by the employer. (*Id.* at ¶ 26.) CBIZ-MHM invoiced ML directly for the work performed in connection with the ML audits and MHM retained only a small percentage of the revenue obtained from the audits conducted in its name. (*Id.* at ¶¶ 29-30.) In fact, CBIZ's direct involvement in the audits is reflected in the engagement letters themselves which state, among other things, that CBIZ will be provided access to ML's accounting and financial records and, more importantly, that the ML audits will be staffed with *professional and administrative personnel employed by CBIZ.* (*See, i.e.,* Exhibit B to Defendants' Motion at MHM007912, MHM 007917.) Having contracted with ML in the engagement letters to use CBIZ accounting professionals to perform the ML audits, it is disingenuous for CBIZ to argue that CBIZ cannot be held responsible for its professionals'

malpractice.

CBIZ was directly involved in the failed audits and its attempt to turn this motion into a procedurally and substantively deficient motion for summary judgment should be rejected.

2. Plaintiff Has Adequately Alleged Facts Giving Rise To A Joint Venture Between CBIZ and MHM and CBIZ's Vicarious Liability For The Failed Audits.

The Complaint also alleges facts under which CBIZ may be held vicariously liable for the failed ML audits.

Vicarious liability for concerted action may be found to exist when tort-feasors have entered into a joint enterprise or joint venture. *See Sparks v. Republic Nat'l Life Insurance* Co., 647 P.2d 1127, 1138 (Ariz. 1982). "A joint venture is formed when two or more parties agree to pursue a particular enterprise in the hope of sharing a profit." *Ellingson v. Sloan*, 527 P.2d 1100, 1103 (Ariz. App. 1974).

There are four required elements to establish a joint venture: (1) a contract or agreement, (2) a common purpose, (3) a community of interest, and (4) an equal right of control. *Sparks*, 132 Ariz. at 540. "Where a joint venture exists, each of the parties is the agent of the others and each is likewise a principal so that the act of one is the act of all." (*Id.*) Joint venture partners are "subject to a common duty, the breach of which will subject those persons to liability for the entire harm resulting from the failure to perform the duty." (*Id.*)

CBIZ again attempts to turn this motion to dismiss into a motion for summary judgment by trying to *prove* that CBIZ and MHM did not "intend" to form a joint venture and did not violate rules which clearly prohibited CBIZ from performing audits.[5] CBIZ

[5] As Defendants acknowledge, Arizona law requires accountants to own at least a 51% stake in the ownership of their firm. *See* A.R.S. § 32-731(A)(2). Professional standards promulgated by the American Institute of Certified Public Accountants ("AICPA") also warn against the same firm from performing both audit and consulting services as this could very well impair the auditor's independence. AICPA Code of Professional Conduct § 101-3.

inappropriately attaches a copy of the Administrative Services Agreement (which it refers to as the "ASA") between CBIZ and MHM even though this agreement was never referenced in Plaintiff's Complaint. But even if that document could be considered in the context of this motion -- and it should not be[6] -- it certainly would not resolve the issue because, as the Arizona Supreme Court has recognized "where there is a question of a joint adventure, *each case must be decided upon its own facts*." *West v. Soto*, 336 P.2d 153, 157 (Ariz. 1959); *Ellingson*, 527 P.2d at 1104 ("Where there is a question as to the existence or nature of a joint venture, each case must be resolved upon its own facts.")[7] (Emphasis added.)

As set forth more fully above, it is clearly alleged that: (1) CBIZ and MHM agreed to form CBIZ-MHM with the mutual purpose of generating and sharing revenue and profits through the provision of audit services (Complaint, ¶ 33); (2) the ML audit personnel were CBIZ employees, had CBIZ email addresses and business cards, and were compensated by CBIZ (*Id*. at ¶ 28); (3) CBIZ exercised control over the expenses and staffing on ML audits,

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[6] Plaintiff is cognizant that documents attached to or referenced in the Complaint may be considered in the context of a motion to dismiss. However, contrary to what Defendants have represented to the Court, the ASA was neither attached nor referenced in the Complaint. The ASA should not be considered in connection with Defendants' "Motion to Dismiss." *Qwest Corp. v. City of Globe, Arizona*, 237 F.Supp.2d 1115 (D. Ariz. 2002). ("In the context of a motion to dismiss for failure to state a claim, the Court generally will not consider items outside the complaint.")

[7] The language in the ASA that the "agreement does not…involve a joint venture" may be binding upon MHM and CBIZ, however, it is not conclusive of the existence of a joint venture. Such disclaimers are not controlling as to third parties. *See, e.g., In Re Parmalet Sec. Litig.*, 375 F.Supp.2d 258, 294 (S.D.N.Y. 2005); *see also* Restatement (Third) of Agency § 1.02 ("How the parties characterized the relationship is not dispositive…."). The substance of MHM and CBIZ's relationship as determined by the evidence, is what matters. *See Tafoya v. Trisler*, 445 P.2d 452, 455 (Ariz. App. 1968) ("The intent of the contracting parties to form a partnership is always an essential element of a partnership relation [a]s between the parties themselves, *but as to third parties, the relation will be determined from the facts rather than the conclusions of the co-partners as to the nature of their business relationship*.") (emphasis added); *see also Union Carbide Corp. v. Montell N.V.*, 944 F. Supp. 1119 (S.D.N.Y. 1996) ("[S]tatements [in agreement] that no partnership is intended are not conclusive.")

and CBIZ was the only source of compensation for work performed by MHM personnel on the ML audits" (*Id.*); (4) CBIZ and MHM marketed themselves as "one" firm and they, in substance, operated as "one unified business" (*Id.* at ¶ 21, 26); and (5) CBIZ and CBIZ-MHM exercised control over the audit services provided by MHM (*Id.* at ¶ 31).

Plaintiff has alleged facts which give rise to joint venture relationship between MHM and CBIZ, such that CBIZ may be held vicariously liable for the various audit failures alleged. Defendants' thinly disguised motion for summary judgment should be denied.

B. <u>CBIZ's Attempt To Invoke Its Fact-Specific Statute of Limitation Defense In The Context Of Its Motion to Dismiss Should Also Be Rejected.</u>

CBIZ seeks dismissal of Plaintiff's negligence-based claims (not Plaintiff's breach of contract claim) on the grounds that these claims are barred by the applicable two-year statute of limitation, even after giving consideration to the two-year tolling provision in federal bankruptcy law (11 U.S.C. § 108(a)). (Motion, pp. 15-17.)

CBIZ's entire argument hinges on CBIZ's conclusory assertion that Plaintiff should somehow have discovered CBIZ's wrongful conduct and Plaintiff's resulting injuries (thereby triggering the statute) on the day ML collapsed into bankruptcy in June 2008. (*Id.* at p. 16) ("ML's cause of action accrued -- at the very latest -- when it was forced into bankruptcy in June 2008."). However, the statutes of limitations for all claims was tolled by operation of 11 U.S.C. § 108 for a period of no less than two years from the date of the order or relief in bankruptcy (i.e. until June 24, 2010). Further, as alleged in the Complaint, on December 22, 2009 the Plaintiff entered into a Tolling Agreement with "Mayer Hoffman McCann, P.C., on behalf of its shareholders, *and affiliates*" which remained effective as of the date the Complaint was filed. (Complaint, ¶ 8.) Therefore, Plaintiff's claims against CBIZ (and MHM) are timely.

Moreover, in Arizona, claims against professionals, including, accountants are governed by the discovery rule and do not accrue until "the plaintiff knows, or in the exercise of reasonable diligence should have known, of the defendant's negligent conduct."

Sato, 599 P.2d at 183. Accrual does not occur until a plaintiff discovers an injury *and* the causal connection between the injury and a particular defendant's wrongful conduct. *See Lawhon*, 765 P.2d at 1007. These are questions of fact for the jury. *Doe*, 955 P.2d at 961; *see also Logerquist*, 932 P.2d at 287.

The Complaint clearly alleges that ML management relied heavily upon Defendants, as accounting professionals, to assist and "advise" ML with respect to, among other things, the application of GAAP. (Complaint, ¶¶ 49, 51-57). CBIZ's wrongful conduct resulted in the undetected, undisclosed material misstatement of ML's year-end financial statements. (*Id.* at ¶ 40.) Year after year, the unqualified audit reports left ML's Board and management with a serious misimpression as to ML's true financial condition. (*Id.* at ¶¶ 34, 35, 108.) Defendants' wrongful conduct and misrepresentations concealed ML's true financial condition, thereby artificially prolonging its existence and deepening ML's insolvency. (*Id.* at ¶¶ 123-126.)[8]

"The defense of statute of limitations is never favored by the courts," and, as such, resolution of this fact-intensive inquiry should await completion of discovery. *Gust Rosenfeld*, 898 P.2d at 968. CBIZ's motion should be denied on this basis alone.

CBIZ's argument, however, should also be rejected because, as alleged, Plaintiff entered into a tolling agreement with MHM "and its affiliates." (Complaint, ¶ 8; Motion,

[8] CBIZ's self-serving conclusion that the collapse of ML should have alerted Plaintiff to Defendants' wrongful conduct and the fact that it was injured by that conduct is not only inappropriate at this stage of the proceeding, it is flawed. Plaintiff was certainly not going to presumptively file a lawsuit against Defendants without first conducting a reasonable investigation. In fact, Section 108 of the Bankruptcy Code is designed to allow such an orderly investigation. *Matter of Princeton-New York Investors, Inc.*, 199 B.R. 285, 297 (Bkrtcy. D.N.J. 1996) ("Section 108(a) grants the trustee time to evaluate claims held by the estate and to sort out the affairs of the estate in an orderly fashion."). It was only after Plaintiff was able to obtain Defendants' audit work papers and hire consultants to review the ML audit accounting working papers (which contain the "audit evidence") that Plaintiff could have discovered Defendants' wrongful conduct and the fact that ML had been injured as a result of that misconduct. Defendants' June 2008 "accrual" date should be disregarded.

Exhibit I.) Notwithstanding all of the well-pled allegations which evidence a clear affiliation between MHM and CBIZ, CBIZ argues it is not an "affiliate" of MHM and, therefore, that it cannot be bound by the agreement. (Motion, p. 17.) At best, CBIZ's contention raises questions of fact pertaining to the making of the agreement, the relationship between CBIZ and MHM and whether they are, in fact, "affiliated," and the true intent of the parties to the tolling agreement. A motion to dismiss is not the proper vehicle for resolving these factual issues. *See Schade v. Diethrich*, 760 P. 2d 1050, 1057 (Ariz. 1988) ("Decisions on the making, meaning and enforcement of contracts should hinge on the manifest intent of the parties rather than on a judge's view…"); *Leo Eisenberg & Co., Inc. v. Payson*, 785 P.2d 49 (Ariz. 1989) (where "the language of the contract reasonably can be construed in more than one manner, the intent of the parties was a question for the trier of fact to resolve…") Further, CBIZ's insinuation that MHM was not authorized to bind its affiliate, CBIZ, is also unavailing as the question of MHM's actual or apparent authority is also one of fact. *Corral v. Fid. Bankers Life Ins. Co.*, 630 P.2d 1055, 1058 (Ariz. App. 1981); *see also U.S. Fidelity & Guaranty Co. v. Powercraft Homes, Inc.*, 685 P.2d 136, 141 (Ariz. App. 1984) (whether an agent or authorized representative has actual or apparent authority is a question of fact). Thus, CBIZ's efforts to escape liability based on the state of limitations should be denied.

V. CONCLUSION.

For the reasons set forth herein, Plaintiff respectfully requests that the Court enter an Order denying Defendants' Joint Motion to Dismiss Complaint.

RESPECTFULLY SUBMITTED: this 20th day of December, 2010.

DICARLO CASERTA MCKEIGHAN & PHELPS PLC

/s/ Nicholas J. DiCarlo
Nicholas J. DiCarlo
Christopher A. Caserta

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