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IN THE UNITED STATES DISTRICT COURT

THE DISTRICT OF ARIZONA

ML LIQUIDATING TRUST, as successor-in-interest to Mortgages Ltd.

Plaintiff,

v.

MAYER HOFFMAN MCCANN, P.C., a Missouri professional corporation; CBIZ, Inc., a Delaware corporation; CBIZ MHM, LLC, an Ohio limited liability company,

Defendants.

Case No. CV_____

NOTICE OF REMOVAL PURSUANT TO 28 U.S.C. §§ 1441 AND 1452

Presently pending before the Superior Court of Arizona, County of Maricopa, under Case No. CV2010-053947.

Defendants Mayer Hoffman McCann P.C., CBIZ, Inc., and CBIZ MHM, LLC (collectively "Defendants"), give notice of the removal of this action from the Superior Court of Arizona, County of Maricopa, to this Court pursuant to 28 U.S.C. §§ 1441 and 1452, and state:

1. Defendants are the defendants in a civil action filed in, and pending before, the Superior Court of Arizona, County of Maricopa, styled *ML Liquidating Trust v. Mayer Hoffman McCann P.C. et al.*, Case No. CV2010-053947 ("State Action"). The State Action was filed by the ML Liquidating Trust ("Trust") as successor-in-interest to Mortgages Ltd. ("ML"). The Trust alleges that, between 2004 and 2008, Mayer Hoffman issued audits for ML misrepresenting both (1) that ML's financial statements reflected its financial health and comported with Generally Accepted Accounting Principles, and (2) that Mayer Hoffman's audits followed Generally Accepted Auditing Standards. (*See, e.g.*, State Action Compl. ¶ 117 (attached as Ex. A) (hereinafter "Compl.").) The Trust filed its Complaint in the State Action on August 26, 2010. The Trust has yet to serve the Complaint on any party.

2. This Notice of Removal is being filed within 30 days after Defendants received a copy of the Complaint setting forth the claims for relief upon which the State Action is based. *See* 28 U.S.C. § 1446(b). In addition, all Defendants in the State Action consent to the removal and join this Notice of Removal.

3. Copies of all process, pleadings, and orders received by Defendants in the State Action are attached at Exhibit A. *See id.* § 1446(a). In addition, pursuant to District of Arizona Local Rule 3.7(a), Defendants affirmatively note that a copy of this notice has been filed with the clerk of the state court from which the State Action has been removed. *See also* 28 U.S.C. § 1446(d). Defendants will also promptly give notice of the State Action's removal to the Trust. *See id.*

4. The Court has original jurisdiction over the State Action pursuant to diversity jurisdiction under 28 U.S.C. § 1332(a)(1). The parties are "citizens of different States" and the amount in controversy "exceeds the sum or value of $75,000." *Id.*

a. Defendant Mayer Hoffman McCann P.C. is a professional corporation. For purposes of diversity jurisdiction, professional corporations are treated as ordinary corporations. *See Kuntz v. Lamar Corp.*, 385 F.3d 1177, 1182 (9th Cir. 2004). Mayer Hoffman is incorporated under Missouri law with its principal place of business in Kansas. (*See* Compl. ¶ 4.) It is thus a citizen of Missouri and Kansas. *See* 28 U.S.C. § 1332(c)(1).

b. Defendant CBIZ, Inc., is a corporation incorporated under Delaware law with its principal place of business in Ohio. (*See* Compl. ¶ 5.) CBIZ, Inc., is thus a citizen of Delaware and Ohio. *See* 28 U.S.C. § 1332(c)(1).

c. Defendant CBIZ MHM, LLC, is a limited liability company. A limited liability company is "a citizen of every state of which its owners/members are citizens." *Johnson v. Columbia Props. Anchorage, LP*, 437 F.3d 894, 899 (9th Cir. 2006). CBIZ Operations, Inc., is the sole member of CBIZ MHM. CBIZ Operations, Inc., is incorporated under the laws of, and has its principal place of business in, Ohio. It is thus an Ohio citizen. *See* 28 U.S.C. § 1332(c)(1). CBIZ MHM, LLC, is, in turn, an Ohio citizen. *See Johnson*, 437 F.3d at 899.

d. The Trust is a liquidating trust organized under Arizona law. (*See* Compl. ¶ 3.) "A trust has the citizenship of its trustee or trustees." *Johnson*, 437 F.3d at 899 (citing *Navarro Sav. Ass'n v. Lee*, 446 U.S. 458, 464 (1980)). Kevin O'Halloran is the trustee of ML Liquidating Trust. (*See* Compl. ¶ 3.) Upon information and belief, O'Halloran is a citizen of Georgia. Bankruptcy filings in ML's bankruptcy case assert that O'Halloran is "from Atlanta, Georgia." (Doc. 1531, Amended Disclosure Statement, at 51, *In re Mortgages Ltd.*, No. 2:08-bk-07465-RJH.) As a result, because Mayer Hoffman, CBIZ, and CBIZ MHM are all citizens of different States from the Trust, complete diversity exists under 28 U.S.C. § 1332(a)(1).

e. Finally, the Trust seeks more than $75,000. *Id.* § 1332(a). The Trust specifically alleges that "Defendants' wrongful conduct . . . resulted in damages totaling no less than $100 million." (Compl. ¶ 126.) *See Singer v. State Farm Mut. Auto. Ins. Co.*, 116 F.3d 373, 375 (9th Cir. 1997) (noting that "the sum claimed by the plaintiff controls for removal purposes unless it is apparent, to a legal certainty, that the plaintiff cannot recover the amount claimed") (internal quotation marks omitted).

5. The Court also has original jurisdiction over the State Action pursuant to bankruptcy jurisdiction under 28 U.S.C. § 1334(b). Section 1334(b) gives the Court jurisdiction over "all civil proceedings arising under title 11, or arising in or related to cases under title 11." *Id.*

a. ML was forced into bankruptcy in the Bankruptcy Court for the District of Arizona in June 2008. (*See In re Mortgages Ltd.*, No. 2:08-bk-07465-RJH.) On May 20, 2009, the bankruptcy court issued an order that confirmed the First Amended Plan of Reorganization in ML's bankruptcy case. (*See* Doc. 1755, Order Confirming Plan, *In re Mortgages Ltd.*, No. 2:08-bk-07465-RJH.) As directed under the Plan, the Trust must assist in liquidating ML's remaining assets, and the reorganized ML will cease to exist once the Trust expires. (*See* Doc. 1532, First Amended Plan, §§ 4.4, 6.2, *In re Mortgages Ltd.*, No. 2:08-bk-07465-RJH (hereinafter "First Amended Plan").)

b. Given this procedural posture, the Court has jurisdiction over the State Action at least under § 1334(b)'s "related to" jurisdiction. "'[R]elated to' jurisdiction is very broad." *Sasson v. Sokoloff* (*In re Sasson*), 424 F.3d 864, 868 (9th Cir. 2005). While the Ninth Circuit has held that "related to" jurisdiction typically covers only those post-confirmation lawsuits that have a "'close nexus'" to the bankruptcy plan, *State of Montana v. Goldin* (*In re Pegasus Gold Corp.*), 394 F.3d 1189, 1194 (9th Cir. 2005) (noting "that matters affecting the interpretation, implementation, consummation, execution, or administration of the confirmed plan will typically have the requisite close nexus") (internal quotation marks omitted), the Ninth Circuit "has yet addressed" whether the close-nexus standard applies to a case "involving a liquidating plan of reorganization" like the ML Plan

at issue here, *Boston Reg'l Med. Ctr., Inc. v. Reynolds* (*In re Boston Reg'l Med. Ctr., Inc.*), 410 F.3d 100, 107 (1st Cir. 2005). For the reasons articulated by the First Circuit, the Ninth Circuit, when it does confront that question, will hold that the broader pre-confirmation test applies to liquidating plans like the ML Plan. *See id.* at 105-07 (applying pre-confirmation test—whether lawsuit conceivably could affect bankruptcy estate—after liquidating plan had been confirmed); *Lindsey v. Travelers Indem. Co.*, No. CV 06-609-PHX-MHM, 2007 WL 841411, at *4-5 (D. Ariz. Mar. 16, 2007) (applying pre-confirmation test to post-confirmation claim). In all events, this Court has "related to" jurisdiction over the State Action even under the narrower close-nexus test.

c. To begin with, courts have routinely found the close-nexus test satisfied in cases, like this one, "involving trusts that are successors to the interests of liquidating or reorganized debtors." *Harrow v. Street* (*In re Fruehauf Trailer Corp.*), 369 B.R. 817, 822 (Bankr. D. Del. 2007); *see, e.g.*, *Krys v. Sugrue*, No. 08 Civ. 3065, 2008 WL 4700920, at *6 (S.D.N.Y. Oct. 23, 2008); *Kirschner v. Grant Thornton LLP* (*In re Refco, Inc. Sec. Litig.*), 628 F. Supp. 2d 432, 443 (S.D.N.Y. 2008); *Air Cargo, Inc. Litig. Trust v. i2 Techs., Inc.* (*In re Air Cargo, Inc.*), 401 B.R. 178, 187-89 (Bankr. D. Md. 2008); *Morris v. Zelch* (*In re Reg'l Diagnostics, LLC*), 372 B.R. 3, 23-25 (Bankr. N.D. Ohio 2007); *Astropower Liquidating Trust v. Xantrex Tech., Inc.* (*In re AstroPower Liquidating Trust*), 335 B.R. 309, 323-25 (Bankr. D. Del. 2005).

d. The very reason that the Plan established the Trust, moreover, was "*solely* to implement the Plan." (First Amended Plan § 6.2 (emphasis added).) By definition, therefore, the Trust's lawsuit represents a "matter[] affecting the . . . implementation [and] execution . . . of the confirmed plan," thus satisfying the close-nexus test. *Pegasus*, 394 F.3d at 1194 (internal quotation marks omitted). Otherwise the Trust would be acting outside its assigned authority solely to implement the Plan.

e. The Plan's specific terms confirm this close nexus to the Plan. It expressly gives the Trust the rights "in [ML's] Non-Loan Assets," including any "Causes of Action" that ML may have against third-parties. (First Amended Plan § 6.6.) Indeed, the

Plan explicitly identifies a list of "potential targets," including Mayer Hoffman, against whom the Trust believed ML had pre-petition claims. (*Id.* § 4.3 & Ex. 1.) "Accordingly, the 'implementation' and 'execution' of the confirmed Plan are directly at issue as the very claims being prosecuted by the Trust[] 'arise under the Plan.'" *Refco*, 628 F. Supp. 2d at 443. In these circumstances, "[w]hen the matter at hand involves the liquidation of pre-petition claims assigned to the trust by the plan, the nexus is usually sufficient to confer post-confirmation jurisdiction over the matter." *In re WRT Energy Corp.*, 402 B.R. 717, 726 (Bankr. W.D. La. 2007). A contrary decision, by contrast, would allow a debtor to use a trust illegitimately "as a vehicle for escaping federal jurisdiction," rather than legitimately as a tool "to focus preconfirmation on the more pressing needs of its reorganization or liquidation while deferring issues regarding . . . causes of action . . . until after confirmation of its plan." *Refco*, 628 F. Supp. 2d at 444 (internal quotation marks omitted); *see also Krys*, 2008 WL 4700920, *8 ("Adoption of the SPhinX Plaintiffs' position here would effectively allow federal subject matter jurisdiction to be manipulated by parties' contractual arrangements within the formation of a post-confirmation trust.").

f. The jurisdictional provisions of the Plan also illustrate the close nexus that exists here. The Plan expressly provides for the bankruptcy court's continuing jurisdiction "[t]o determine all . . . Causes of Action brought by the Liquidating Trust." (First Amended Plan § 9.1(i).) "[W]here, as here, the Plan specifically describes an action over which the Court had 'related to' jurisdiction pre-confirmation and expressly provides for the retention of such jurisdiction to liquidate that claim for the benefit of the estate's creditors, there is a sufficiently close nexus with the bankruptcy proceeding to support jurisdiction post-confirmation." *AstroPower*, 335 B.R. at 325.

g. Lastly, the Trust and the lawsuits that it brings to recover funds as a representative of ML will serve to benefit ML's unsecured creditors, which are "beneficiaries" of the Trust. (First Amended Plan §§ 3.6(l)-(r), 6.7.) Many courts have recognized a close nexus between a Trust's lawsuit and the Plan where, as here, any proceeds of the lawsuit will go to creditors. *See, e.g.*, *Krys*, 2008 WL 4700920, *6 (finding

a "'close nexus' between the Trustee's claims and the bankruptcy proceeding" where "any funds recovered by the . . .Trust in this case will go directly to [the debtor's] largest creditors); *Reg'l Diagnostics*, 372 B.R. at 23 ("While the potential to increase recovery to the creditors or former creditors of the estate is not enough alone to confer jurisdiction, potential benefit to creditors or former creditors weighs in favor of jurisdiction.").

h. In sum, given all these connections to the Plan and the bankruptcy proceedings, the Trust's lawsuit satisfies even the close-nexus test. *A fortiori* it satisfies the very broad test for related-to jurisdiction applicable when the Plan at issue is a liquidation plan. The State Action raises both core and non-core issues. Defendants do not consent to entry of final orders or judgments by the bankruptcy court on non-core issues.

6. This action is properly removed pursuant to 28 U.S.C. §§ 1441 and 1452.

Dated: September 21, 2010

Respectfully submitted,

/s/ *Katherine V. Brown*

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Mayer Hoffman McCann P.C.

CERTIFICATE OF SERVICE

I hereby certify that on September 21, 2010, I electronically filed the foregoing Notice of Removal with the Clerk of the Court using the CM/ECF system and served the following parties by U.S. mail:

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Christopher A. Caserta
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Counsel for ML Liquidating Trust

/s/ *Katherine V. Brown*
One of the Attorneys for CBIZ, Inc., CBIZ MHM, LLC, Mayer Hoffman McCann P.C.

EXHIBIT A

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IN THE SUPERIOR COURT STATE OF ARIZONA

IN AND FOR THE COUNTY OF MARICOPA

CV2010-053947

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. _____

PLAINTIFF'S CERTIFICATE OF COMPULSORY ARBITRATION

The undersigned certifies that he knows the dollar limits and any other limitations set forth by local rules of practice for the applicable superior court and further, certifies that this case **is not** subject to compulsory arbitration, as provided by Rules 72 through 76 of the ARCP.

RESPECTFULLY SUBMITTED this 26th day of August, 2010.

DICARLO CASERTA & PHELPS PLLC

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Plaintiff,

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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. CV2010-053947

CERTIFICATION PURSUANT TO A.R.S. § 12-2602

The undersigned, as counsel for the Plaintiff herein, hereby certifies pursuant to A.R.S. § 12-2602 that expert opinion testimony may be necessary to prove the licensed professional's standard of care or liability for the claims asserted in the Complaint in this action.

RESPECTFULLY SUBMITTED this 26th day of August, 2010.

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ML LIQUIDATING TRUST, as successor-in-interest to Mortgages, Ltd.

Plaintiff,

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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. CV 2010-053947

COMPLAINT

(JURY TRIAL REQUESTED)

Plaintiff ML Liquidating Trust, as the duly authorized successor-in-interest to Mortgages, Ltd., for its Complaint against the Defendants hereby allege as follows:

I. PARTIES, JURISDICTION AND VENUE.

1. ML Liquidating Trust (the "Trust") was created pursuant to the Investors Committee's First Amended Chapter 1 Plan of Reorganization (the "Plan"). The United States Bankruptcy Court for the District of Arizona confirmed the Plan on May 20, 2009. The Plan became effective on June 15, 2009.

2. The Plan expressly retained Mortgages, Ltd.'s ("ML") causes of action for post-confirmation enforcement by the Trust, pursuant to 11 U.S.C. § 1123(b)(3)(B). The Trust is,

therefore, a duly authorized estate representative with standing to prosecute the claims asserted against the defendants herein.

3. The Trust is a liquidating trust organized under Arizona law. Kevin O'Halloran serves as the Trustee of the Trust.

4. Mayer Hoffman McCann, P.C. ("MHM") is a professional corporation doing business in the State of Arizona. MHM is incorporated in the State of Missouri, with its principal place of business located in Kansas.

5. CBIZ, Inc. ("CBIZ") is a publicly traded (NYSE: CBZ) firm which provides professional financial services. CBIZ is a Delaware corporation doing business in Maricopa County, Arizona. As set forth herein, CBIZ controls and is otherwise affiliated with MHM and CBIZ MHM, LLC.

6. CBIZ MHM, LLC ("CBIZ-MHM") is a Delaware limited liability company which is registered as a foreign corporation doing business in Arizona. As set forth herein, CBIZ-MHM is affiliated with CBIZ and MHM and otherwise controls MHM.

7. The amount in controversy exceeds the minimum jurisdiction requirements of this Court, and jurisdiction and venue are proper in the Maricopa County Superior Court.

8. The statutes of limitation for the claims asserted herein were tolled pursuant to the provisions of 11 U.S.C. § 108, for a period of no less than two years from the date of the order for relief in bankruptcy. Additionally, on December 22, 2009, Plaintiff ML Liquidating Trust entered into a Tolling Agreement with "Mayer Hoffman McCann P.C., on behalf of its shareholders, and affiliates..." The Tolling Agreement remains in place and effective as of the date of this Complaint. Plaintiff's claims against MHM and its affiliates CBIZ and CBIZ-MHM are, therefore, timely.

II. GENERAL ALLEGATIONS.

A. Overview of ML's Business.

10. For over 40 years, ML provided private mortgage broker and banking services before it suddenly collapsed and filed bankruptcy in 2008.

11. As a private mortgage banker, ML provided an alternative to commercial banks in providing liquidity to the Arizona mortgage and real estate market.

12. Like many financial businesses, ML's business strategy changed over time. By the middle of the past decade, ML was providing short-term loans for commercial renovations or large real estate developments until they received "take out" financing from a more traditional lender such as a bank. This model was premised upon the reluctance of most commercial banks to make loans for the purpose of acquiring and developing raw land or for renovating existing structures. ML was, therefore, filling a market niche.

13. ML generated revenue through its loan origination services and through the loan servicing rights which ML retained in connection with the origination and funding of each of the loans it originated.

14. ML funded the loans that it originated with money from two principal sources, investors and its own funds. When investor funds were insufficient, ML used its own money to fund the loan, and either sold its interest in the loans to future investors at a later date or kept its interest in the loan.

15. ML raised funds from investors in one of two ways. First, ML offered its clients direct investment opportunities in a specific loan, granting the investor an interest in the loan and a lien interest in the real estate collateral securing the loan ("Pass-Through"). ML also offered membership interests in multiple ML-managed funds (the "MP Funds"). The MP Funds then pooled members' money and invested in a variety of loans originated by ML. Like the Pass-Through

investors, the MP Funds received an interest in the loans they invested in and a lien interest in the real estate collateral.

16. MP Funds offered investors the advantage of diversifying an investment over multiple loans. At the time of ML's bankruptcy, there were nine active MP funds, each a separate LLC managed by ML.

17. Radical Bunny, LLC ("Radical Bunny"), an unrelated entity comprised of various individual investors, was also a major investor in loans originated by ML. Although Radical Bunny initially invested in loans originated by ML, in 2005 Radical Bunny began making direct loans to ML. At that time, Radical Bunny was also ML's largest investor, with approximately $140 million invested in ML-originated loans.

18. From 2005 forward, Radical Bunny was ML's primary source of financing for both its own business operations and as ML's largest investor.

B. ML's Longstanding Relationship With MHM (and Predecessor Miller Wagner) CBIZ and CBIZ-MHM.

19. Not surprisingly, ML's business experienced considerable growth as the Arizona real estate market experienced an enormous surge in land acquisition and development. As ML grew with the market, so too did ML's need for a top-tier professional audit and financial services firm.

20. Established in 1977, Phoenix-based accounting firm of "Miller Wagner & Company Ltd." provided audit services to ML dating back to at least the 1990's. In 1999, however, Miller Wagner became CBIZ Miller Wagner, LLC as part of a consolidation with Century Business Services, Inc. (CBIZ), a rapidly expanding financial services provider. Upon information and belief, "Miller Wagner & Company, PLLC" (hereinafter "Miller Wagner") was formed as the independent certified public accounting firm which continued to provide audit and attest services for clients such as ML.

21. In 1999, CBIZ also joined with Defendant MHM, a Kansas-based accounting firm that had been providing audit services since the mid-1950s. Defendants CBIZ and MHM formed Defendant CBIZ-MHM, a joint venture which, as discussed more fully below, would allow CBIZ to realize substantial revenue from audit services provided by MHM. According to its website, CBIZ-MHM "provides a wide range of accounting and business management services to assist both individuals and small to medium-sized businesses in meeting all of their diverse needs." Stressing the unity between the two firms, the website goes on to state that "*together CBIZ and MHM* [currently] rank as *one* of the Top Ten accounting providers in the US."

22. In 2003, Miller Wagner 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. Upon information and belief, in connection with the transition from Miller Wagner to MHM, the Miller Wagner partners who were previously responsible for ML's audits were admitted as shareholders of MHM.

23. In marketing its audit services to clients such as ML, MHM touts its "close alignment" and "strategic association" with CBIZ which provides a "comprehensive range of business services, products and solutions that help our clients grow and succeed."

24. Miller Wagner's eventual transition into MHM and MHM's close association with CBIZ provided ML with additional comfort regarding the audit services it could expect as MHM's national presence and "close alignment" with CBIZ suggested that MHM could and would now be able to bring a much broader array of skills and resources to bear in connection with its audits of ML's financial statements audits.

25. ML's expectation in this regard was not unreasonable. To the contrary, this expectation was fostered by MHM and CBIZ who addressed the transition as follows:

> Miller Wagner & Company, PLLC, an independent Certified Public Accounting firm, has evolved into the independent CPA firm of Mayer

> Hoffman McCann P.C., providing Phoenix-area businesses with a national alternative.
>
> CBIZ MHM, LLC became part of the national CBIZ family in 1999. Miller Wagner & Company, PLLC's evolution to Mayer Hoffman McCann P.C. is the next logical step. *Mayer Hoffman McCann P.C. offers the resources and expertise of a national firm* with the insights and feel of a local business. It *allows us to provide you with access to extensive nationwide resources* -- with first-rate responsiveness and personal attention. [Emphasis added.]

26. In substance, MHM, CBIZ and CBIZ-MHM operate as one unified business. They share revenues from their attest services, including audit services; and CBIZ and CBIZ-MHM have the right to hire and fire and determine the compensation of MHM employees.

27. MHM and CBIZ share the same office space in Phoenix with the same entry and receptionist. The same managing partner manages both the CBIZ and MHM practices and the MHM partner in charge of the ML audits was both a shareholder in MHM and CBIZ-MHM.

28. The MHM accountants who performed ML's audits for the years 2005, 2006, and 2007 were CBIZ employees, they used CBIZ business cards (not MHM cards), had "CBIZ" email addresses. 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.

29. Because CBIZ collected the money that was paid by MHM's audit clients, CBIZ-MHM invoiced ML for MHM's audit work and ML paid fees directly to CBIZ-MHM.

30. 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. CBIZ' arrangement with CBIZ-MHM and MHM enables CBIZ to do indirectly that which CBIZ cannot do directly as a public company -- generate substantial revenues from providing audit and attest services.

31. CBIZ and CBIZ-MHM exercise pervasive control over MHM and the audit services provided by MHM. 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. They both failed to fulfill this responsibility.

32. MHM, CBIZ and CBIZ-MHM are hereinafter collectively referred to as "Defendants."

C. Defendants' Unqualified Audit Reports Conceal ML's True Financial Condition, Thereby Driving ML Deeper and Deeper Into Insolvency.

33. Defendants were engaged to perform audits of the financial statements of ML and its affiliates for the fiscal years ended 2004 through 2007. For the fiscal year-ended 2006, Defendants were also engaged by ML, as managing member of the MP Funds, to perform audits on behalf of each of the MP Funds.

34. Year after year, Defendants affirmatively represented to ML, its Board, and management that it conducted its audits of the financial statements of ML and its affiliates in accordance with Generally Accepted Auditing Standards ("GAAS"), the professional standards governing an auditor's work. Year after year, Defendants also affirmatively represented that the financial statements of ML and its affiliates were fairly stated in accordance with Generally Accepted Accounting Principles ("GAAP"). As set forth herein, unbeknownst to ML, its Board, and management, these representations were materially false and misleading in that Defendants' audits did not comport with GAAS and ML's financial statements were, in fact, materially misstated under GAAP.

35. The clean, unqualified audit reports issued by Defendants provided ML, its Board, and management with the confidence and comfort that ML could safely continue to leverage its balance sheet to expand its business.

36. For instance, between 2004 and 2007, ML's revenues grew over 200% as the loans originated and serviced by ML grew from approximately $380 million to over $700 million. During

this same period, "Mortgage Investments" on ML's balance sheet ballooned from $4.4 million to approximately $303 million.

37. Defendants knew or should have known that ML's rapid growth could and would serve to mask losses on loans originated by ML (and held on its books) and should have factored this growth into its audit procedures. However, as set forth herein, as a result of Defendants' numerous audit failures, there were massive losses and liabilities which should have been but were not being reflected in ML's financial statements.

38. Among other things, under GAAS, Defendants were charged with the responsibility for evaluating the carrying value of ML's "Mortgage Investments," which included various loans "held for sale or investment." Had Defendants performed a GAAS audit and given due consideration to the various external factors which impacted ML's business (including the impact of a declining economy and the unique nature of the installment-like construction loans being made by ML), Defendants (and ML) would have realized that many of the loans on (and off) ML's books were "impaired" well before ML's 2008 bankruptcy. Instead of requiring that some reserve be recorded with respect to many of these loans, Defendants turned a blind eye. In fact, Defendants knew or should have known that ML's financial statements were materially misstated as a result of Defendants' failure to appropriately evaluate and measure impairment relating to ML's mortgage investments.

39. Defendants' audit failures are not limited to their failure to evaluate impairment on loans originated by ML. Defendants' audit failures also stem from their apparent disregard of GAAP or, perhaps, sheer incompetence. For example, ML's 2006 financial statements included a $48 million "Due from Related Party" on ML's balance sheet. As set forth herein, under GAAP, this balance was required to be booked as a reduction in shareholder equity. Instead, it was improperly classified as an "asset" on ML's balance sheet. As set forth herein, Defendants fully understood that

ML and its management were relatively inexperienced with regard to the application of GAAP. In fact, Defendants undertook each of their audits with this knowledge and, therefore, understood that management would be relying heavily upon Defendants to ensure that ML's financial statements were compliant with GAAP, especially when technical accounting issues arose.

40. As a direct result of Defendants' gross departures from GAAS, undisclosed losses and liabilities that materially affected ML's true financial condition were undetected by Defendants' flawed audits. In 2008, faced with an apparently sudden, unsolvable liquidity crisis which stemmed from years of audit failures, ML collapsed into bankruptcy.

41. As a result of Defendants' numerous audit failures, their misrepresentations and ML's justifiable reliance upon those misrepresentations, ML sustained massive financial harm, including but not limited to, the artificial prolongation of ML's existence and the deepening of its insolvency.

III. IN BREACH OF THE PROFESSIONAL DUTIES OWED TO ML, DEFENDANTS' AUDITS VIOLATE GAAS AND SERVE TO CONCEAL THE MATERIAL MISSTATEMENT OF ML'S FINANCIAL STATEMENTS UNDER GAAP.

42. From at least 1998 through 2007, ML and its affiliates retained Defendants to perform audits of ML's year-end financial statements. Defendants represented, among other things, that they would perform their audits in accordance with GAAS and that they did, in fact, perform audits in accordance with GAAS. As set forth herein, this was plainly false.

A. Defendants' Duties Under GAAS As Reflected In Defendants' Own Engagement Letters.

42. Defendants owed ML a duty to perform each of their audits of ML in accordance with GAAS.

43. There are ten GAAS standards promulgated by the American Institute of Certified Public Accountants ("AICPA") as described in AU § 150: three General Standards, three Standards of Field Work, and four Standards of Reporting. Those standards are as follows:

General Standards

1. The audit is to be performed by a person or persons having adequate technical training and proficiency as an auditor.

2. In all matters reliant to the assignment, an independence of mental attitude is to be maintained by the auditor or auditors.

3. Due professional care is to be exercised in the performance of the audit and the preparation of the report.

Standards of Field Work

1. That the work is to be adequately planned and assistants, if any, are to be properly supervised.

2. That sufficient understanding of internal control is to be obtained to plan the audit to determine the nature, timing, and extent of tests to be performed.

3. That sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmation to afford a reasonable basis for an opinion regarding the financial statements under audit.

Standards of Reporting

1. The report shall state whether the financial statements are presented in accordance with generally accepted accounting principles.

2. The report shall identify those circumstances in which such principles have not been consistently observed in the current period in relation to the preceding period.

3. Informative disclosure in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.

4. The report shall contain either an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefore should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's work, if any, and the degree of responsibility the auditor is taking.

44. GAAS also required Defendants in the conduct of their audits of ML to comply with all of the Statements on Auditing Standards ("SAS"), issued by the Auditing Standards Board of the

AICPA as well as the Principles of Ethical Conduct and various other standards promulgated by the AICPA.

45. Defendants' duties under GAAS include, without limitation, the following: (1) the duty to remain independent (AU § 220); (2) the duty to exercise due professional care including, but not limited to, the duty to exercise professional skepticism in the conduct of its audits (AU § 230); (3) the duty to obtain sufficient competent evidential matter to support the assertions made in the financial statements (AU § 326); (4) the duty to communicate material weaknesses and/or significant deficiencies in ML's internal control structure (AU § 325); (5) the duty to report departures from generally accepted accounting principles ("GAAP") (AU § 380); (6) the duty to report adjustments arising from the audit as well as any uncorrected misstatements (AU § 380); and (7) the duty to issue a report that accurately reflects the findings made during its audits (AU § 508).

46. In its audit engagement letter dated November 28, 2006, Defendants made the following representations:

> We are pleased to confirm our understanding of the services we are to provide for ***Mortgages Ltd. and Affiliates***...We will audit the following consolidated financial statements:
>
> 1. Balance Sheet
> 2. Statement of Income and retained earnings
> 3. Statement of cash flows
>
> These statements will be audited by us as of October 31, 2006 and for the year-ended, and as of December 31, 2006 and for the two month period then ended...
>
> ***Our audit will be conducted in accordance with U.S. generally accepted auditing standards and will include tests of your accounting records and other procedures we consider necessary to enable us to express such an opinion. If our opinion is other than qualified we will discuss the reasons with you.*** If for any reason, we are unable to complete our audit or are unable to form or have not formed an opinion, we may decline to express an opinion...

> Our procedures will include tests of documentary evidence supporting the transactions recorded in the accounts and direct confirmation...of receivables and certain other assets ***and liabilities*** by correspondence with selected customers, creditors, and financial institutions.
>
> An ***audit includes examining...evidence supporting the amounts and disclosures in the financial statements...We will plan and perform the audit to obtain reasonable assurance about weather the financial statements are free of material misstatement, whether from errors, fraudulent financial reporting, [or] misappropriate of assets...***
>
> ***[W]e will inform you of any material errors that come to our attention,*** and we will inform you of any fraudulent financial reporting that comes to our attention...
>
> Our audit ***will include obtaining an understanding of internal control sufficient to plan the audit*** and to determine the nature, timing, and extent of audit procedures to be performed...However, ***during the audit, if we become aware of...control deficiencies we will communicate them to you...***
>
> ***We will advise you about appropriate accounting principles and their application and will assist in the preparation of your financial statements...*** [Emphasis added.]

47. Upon information and belief, Defendants' engagement letters issued to ML in connection with Defendants' audits for fiscal years ended December 31, 2004, 2005, and 2007 contain the same, or similar, representations as those made by Defendants in their fiscal year end 1996 audit engagement letter. The same representations were also made to ML, in its capacity as managing member of the MP Funds, in connection with Defendants' November 28, 2006 engagement letter in connection with Defendants' audits of each of the funds.

48. Defendants knew that ML, including its Boards of Directors and management, were entitled to rely upon the representations made by Defendants in each of their engagement letters and did, in fact, intend such reliance.

49. ML and its Board of Directors did, in fact, reasonably and justifiably rely on the representations made by Defendants in each of their engagement letters, including but not limited to the representations that Defendants would perform their audits in accordance with GAAS for the

purpose of determining whether ML's financial statements conformed with GAAP, would test Defendants' accounting records, would communicate any deficiencies in internal control, and, importantly, that Defendants would advise ML of appropriate accounting principles and their application.

50. As reflected in Defendants' workpapers and exemplified herein, Defendants failed to conduct their audits in accordance with GAAS and comply with SAS promulgated by the AICPA in violation of the duty of care they owed to ML. These failures include but are not limited to the following: (1) the failure to exercise due care in the performance of their audits; (2) the failure to maintain their independence; (3) the failure to properly plan their audits; (4) the failure to exercise an appropriate amount of professional skepticism; (5) the failure to increase the scope of their audits in light of the facts and circumstances known to Defendants to ensure that Defendants' audits were supported by competent evidential matter; (6) the failure to discharge their responsibility to evaluate the reasonableness of ML's critical audit estimates; and (7) the issuance of "clean" or unqualified audit reports when Defendants knew or should have known that their audits did not comply with GAAS and that a qualified opinion was required.

B. Defendants Undertake Each of Its Audits of ML With Full Knowledge That ML and Its Accounting Personnel Would Be Relying Heavily Upon Defendants With Respect To The Proper Application Of GAAP.

51. Defendants promise in their engagement letters that they would "advise [ML] about appropriate accounting principles and their application" was extremely important to ML because, as Defendants fully understood and documented in its workpapers, "there [was] no accounting policies manual" at ML or any "manual stating policies that would support the proper preparation of financial statements consistent with GAAP."

52. Defendants were also aware that ML did not have its own internal audit department and, therefore, fully understood at the time that they undertook their audits of ML, that ML and its

accounting personnel would be relying heavily upon Defendants to provide much-needed advice concerning the proper application of GAAP. This is reflected in other workpapers. For instance, in a memorandum drafted in connection with their 2006 audit, Defendants write:

- "Company personnel [including C.F.O. Chris Olson and others] do not have the appropriate tools, such as disclosure checklists, AICPA accounting and audit guides and other authoritative literature necessary to prepare the Company's annual consolidated financial statements."

- "It is strongly recommended that those individuals [including C.F.O. Olson and others] responsible for the maintenance of the Company's accounting records seek out opportunities to enhance their understanding of generally accepted accounting principles."

53. Defendants never withdrew from any of their audits of ML and its affiliates as a result of management's lack of GAAP expertise, nor did Defendants conclude that this deficiency was so severe as to impose an unacceptable limit on the scope of Defendants' audits. To the contrary, Defendants undertook each and every one of their audits of ML with this knowledge and was, thus, required to take management's lack of GAAP expertise into account when conducting their audits.

54. Having concluded that ML management was inexperienced with regard to application of GAAP and having recommended that management attend courses to obtain the requisite knowledge concerning GAAP, Defendants were, therefore, required under GAAS to, among other things, perform their audits with an elevated level of scrutiny and increase the scope of their audits to ensure that their audits and ML's financial statements were supported by *competent* evidential matter. This was especially critical in light of ML's explosive growth and the implications that this growth had on ML's financial reporting.

55. This is especially true because Defendants understood that deficiencies in work performed by ML's accounting personnel coupled with Defendants' flawed audits led to a restatement of ML's 2005 financial statements -- financial statements that had been audited and given a clean audit opinion by Defendants. Consistent with the promise made in their 2006

engagement letter, Defendants actively assisted in the preparation of ML's year end 2006 financial statements so that Defendants were effectively auditing the very financial statements that they helped to prepare.

56. Under the circumstances surrounding their audits of ML, Defendants served not only as an auditor, but also as a financial advisor. In addition to the professional and contractual duties that they owed ML, Defendants, therefore, also owed ML a fiduciary duty.

57. Under GAAS, including but not limited to AU § 311, Defendants were required to plan their audits based upon their overall knowledge of ML's business, including the reasonableness of management's representations and the appropriateness of the accounting principles being applied. In view of ML's rapid expansion and management's relative inexperience with GAAP, Defendants were required to increase the scope of their audits and perform additional substantive testing to ensure that ML's financial statements were properly stated under GAAP as Defendants' opinions repeatedly misrepresented. To the contrary, Defendants' audit plans contained virtually no changes from one year to the next and Defendants' audit workpapers are devoid of any real substantive testing.

C. <u>Defendants' Audits of ML are Tainted by Defendants' Lack of Independence.</u>

58. One of the most important tenets of GAAS is that an auditor maintains independence in mental attitude when conducting an audit. This requirement is set forth in AU § 220 which states:

> This standard requires that the auditor be independent; aside from being in public practice…he ***must be without bias with respect to the client since otherwise he would lack that impartiality necessary for the dependability of his findings,*** however excellent his technical proficiency may be….
>
> It is of utmost importance to the profession that the general public maintain confidence in the independence of independent auditors. To *be* independent, the auditor must be intellectually honest; to be *recognized* as independent, ***he must be free from any obligation to or interest in his client,*** its management, or its owners....

59. Upon information and belief, Defendants lacked independence in mental attitude in the conduct of their audits of ML and its affiliated entities because one or more of Defendants' shareholders/auditors invested directly or indirectly in loans originated by ML and/or directly or indirectly purchased participation interests in limited liability companies which were managed by ML and which served as investment vehicles for loans originated and serviced by ML.

60. Upon information and belief, as a result of these direct and indirect investments in ML and its affiliate entities, Defendants lacked independence in mental attitude in the conduct of their audits of ML and its affiliates in violation of GAAS. This lack of independence undoubtedly tainted Defendants' audit testing and impaired the professional skepticism with which Defendants were required to conduct their audits. Other than sheer negligence or incompetence, these direct or indirect investments by Defendants' auditors and the desire not to lose those investments provides perhaps the best explanation as to why Defendants disregarded any potential going concern problems for years and issued unqualified audit reports concealing ML's true financial health until practically the eve of ML's bankruptcy. Defendants' lack of independence is also manifest in the numerous audit failures exemplified herein.

D. Misstatements Stemming From Defendants' Failure to Properly Evaluate Impairment Relating to ML's "Mortgage Investments."

61. Not all loans originated by ML were "sold" or transferred. Many loans (for one reason or another) were carried on ML's books and reflected on ML's balance sheet as either "held for sale or investment" or "held for benefit of investors."

62. Loans "held for sale or investment" related to loans originated and made by ML which were carried on ML's own books. Between 2004 and 2007, loans "held for sale or investment" ballooned from $4,031,179 to $152,445,923.

63. Loans "held for the benefit of investors" related to amounts funded by investors through ML's Revolving Opportunity Loan Program ("ROLP"). This balance was accounted for as

a secured borrowing transaction on ML's books because ML had the right and obligation to repurchase the investors' participating interests which meant, of course, that ML also bore the risk of loss. This meant that to the extent that the loans being funded through the ROLP were impaired, that impairment which, under GAAP (including but not limited to Concept Statement No. 6), was required to be booked on ML's financial statements. Between 2005 and 2007, loans "held for the benefit of investors" expanded by nearly 300% from $58.6 million to $151.4 million.

64. Between 2004 and 2007, ML's total mortgage investments experienced an astounding 7,500% rate of growth growing from $4, 031,179 to $303,907,118.

65. Not surprisingly, "mortgages held for investment" was characterized as a "major asset" by Defendants with "valuation" being described as the "risk" related to these assets. For some inexplicable (and inexcusable) reason, no such risk was attributed by Defendants to mortgages held on ML's books "for the benefit of investors."

66. Under GAAP, including but not limited to FAS 114, the financial statements of ML were required to include a reserve or "allowance" to reflect "impairment" in the value of ML's "mortgage investments."

67. Under GAAS, and in particular, AU § 342, Defendants were charged with the responsibility for evaluating the reasonableness of accounting estimates used in connection with the preparation of financial statements, including estimates relating to the impairment of assets. In evaluating reasonableness, an auditor must, among other things, compile sufficient competent evidential matter in support of those estimates. In fact, as set forth in AU § 326, "most of the independent auditor's work…consists of *obtaining and evaluating evidential matter.*"

68. As set forth above, Defendants understood that management was relatively inexperienced with regard to the application of GAAP and that it was Defendants' responsibility to evaluate at a substantive level, whether any impairment existed.

69. Year after year, however, Defendants blessed ML's financial statements without *any* reserve whatsoever based largely upon the untested assertions of management and flawed audit procedures which led Defendants to the incorrect conclusion that the underlying collateral was sufficient, that the loans would be fully collectible. In fact, Defendants knew or should have known that the value of ML's "mortgage investments" were materially overstated under GAAP by no later than 2005, thereby causing ML's financial statements to be materially misstated.

70. A proper measurement of impairment at the balance sheet date was critical to ML given the nature of the loans it was originating for itself (and investors), the nature of ML's financing obligations and given the sensitivity of ML's business to the overall economy.

71. As Defendants noted in the 2005 audit workpapers, "[t]he economy is a huge factor in how much revenue the company earns for the year. The economy must be willing to take the risk of obtaining a mortgage loan with the interest rates in effect. With a weak economy, there is a greater potential of default on the loans outstanding." Upon information and belief, similar statements exist in Defendants' workpapers for years ended 2006 and 2007.

72. In as early as 2005, Defendants noted that the "slowing economy has tightened bank lending practices therefore creating higher demand from Mortgages Ltd." While the slowing economy might have created higher demand for loans originated by ML, Defendants knew or should have known that those loans would be higher risk loans to higher risk borrowers who might not otherwise qualify in an environment where banks are tightening their underwriting standards.

73. Defendants also knew that the loans originated by ML were not garden-variety residential home loans. They were typically loans made for the purpose of acquiring land for commercial development or for renovating existing buildings and structures. The loans were typically funded in stages which meant that a developer's ability to complete a project, and hence the *value* of the underlying collateral, would depend on ML's ability to secure and the developer's

ability to access additional funds in the future. Defendants knew or should have known that if those funds were not ultimately available and the developer was not ultimately able to complete the project, that the mortgage investment was essentially unsecured or at best, secured by a half-built project which would require substantial sums of money to complete.

74. As set forth below, Defendants also understood that management implemented a policy whereby ML would acquire an investors' interest in non-performing loans in furtherance of a longstanding policy which stated no investor in loans originated by ML would lose their investment. This meant, of course, that Defendants knew or should have known that, in any given year, ML's "mortgage investments" included "investments" in loans which were impaired under GAAP.

75. ML's workpapers reflect that Defendants were concerned with at most the existence of the loans underlying ML's "mortgage investments." There is, however, little, if any, evidential matter reflecting that Defendants actually performed any substantive testing with respect to the value of these investments. This is so even though Defendants' workpapers clearly reflect, for example, that many of the mortgages "held for sale or investment" were the result of transactions which suggested a GAAP impairment including transactions which were in furtherance of ML's policy to acquire the interests of investors in loans which were underperforming to ensure that the investors did not sustain any loss of their investment. (*See infra* Section III.E.) As reflected in the general ledger transaction detail in Defendants' workpapers, these loans included but are not limited to "cancellations," "delayed fundings," "buy-outs of other investors," loans which should have been closely scrutinized by Defendants for purposes of determining an appropriate GAAP reserve.

76. Defendants' workpapers do not reflect that Defendants ever gave these important factors serious attention in connection with their testing of ML's mortgage investments let alone compiling completed evidential matter to support a zero allowance. Given the nature of the loans, the sensitivity of ML's business to the slowing economy, and given further that Defendants

understood (and documented) that management did "not have formal written lending policies and procedures" and did "not perform regular reviews of the fair market value of REO and other real estate investments," Defendants knew or should have known that the risk of material misstatement relating to ML's mortgage investments was very high and increased the scope of their audits accordingly.

77. In light of these factors, and given the conservatism required under GAAP, GAAS required Defendants to carefully and substantively analyze each and every loan for impairment during each audit. The failure of Defendants' supposedly trained auditors to require *any* valuation reserve under GAAP is simply inexcusable. Again, Defendants understood ML's need to rely upon Defendants' GAAP expertise. Defendants clearly did not provide ML and its management with the accounting expertise and advise which Defendants promised in their engagement letters.

78. A 2007 email written by one of Defendants' auditors states that "the name of the game *this year* is impairment and collateral testing..." In fact, the name of the game each and every year should have been impairment and collateral testing. The failure to place appropriate emphasis on this critical area led to material misstatements in ML's audited financial statements.

79. As a direct result of Defendants' audit failures and the resulting undetected material misstatements in ML's financial statements, including the material understatement of ML's reserves (and hence the material overstatement of ML's "mortgage investments"), ML management unwittingly and disastrously continued to take on additional leverage to grow ML's business.

E. <u>Misstatements Stemming from Defendants' Failure to Evaluate the Off Balance Sheet Risk Related to ML's Rapidly Expanding Serviced Loan Portfolio.</u>

80. ML generated "servicing fees" on loans originated by ML and sold to third parties. ML's business, therefore, depended, in part, on its access to the capital necessary to fund its loans. Therefore, acquiring new investors, retaining its current investors, and generating additional investments from its current investors was very important to ML's business. Between 2004 and

2007, the "loans serviced for others" by ML (which were not included on ML's balance sheet) grew from $382.5 million to well over $700 million.

81. Defendants understood that it was the policy of ML management to redeem the interest of any investor who sought the return of his or her investment. In fact, a significant aspect of the business model dictated that no investor had ever lost their principal.

82. ML management would implement this policy by, for instance, arranging for the investors to be "bought out" of troubled or non-performing loans. ML management often used ML's funds to accomplish a substantial number of these buy-outs, including contractually obligating ML to buy out some Pass-Through investors' interest in loans if the borrowers defaulted. Initially, these buy-outs were funded with ML's own funds, but as liquidity dried up, ML increasingly borrowed money to do this. To ensure the investors recovered their principal, the investors' interest was typically purchased back for the price originally paid when the loan was performing.

83. In response to this, management frequently extended the maturity date of the loans or "re-wrote" the loans, i.e., writing a new loan on the same property, thereby changing the loan amount, terms, and maturity date. Despite the high probability of loss associated with these loans, these loans were often recorded, with Defendants' blessing, without appropriate allowances or reserves in violation of GAAP. As of February 2008, 28 of the 70 loans in ML's loan portfolio (or approximately $339 million out of $901 million total outstanding) were "re-writes." Through this practice of extending and/or re-writing loans, management effectively prevented many troubled loans from going into default; however, as a result of Defendants' wrongful conduct, ML's financial statements, as audited by Defendants, did not accurately reflect the true impairment of these loans under GAAP and, hence, ML's true financial condition.

84. Defendants knew or should have known that GAAP, including but not limited to FAS 114 and Concept Statement No. 6, required that ML's financial statements reflect the risk associated

with this policy in ML's financial statements. To the extent the troubled loans were put on ML's books and included in ML's "mortgage investments," Defendants knew or should have known that an allowance would be required under GAAP. To the extent these serviced loans and the risk of loss associated with them remained "off balance sheet," Defendants knew or should have known that GAAP required, at the very least, a comprehensive explanation of this risk in the notes to ML's financial statements for the benefit of ML, its Board of Directors and investors. Alternatively, as set forth below, Defendants should have required ML to consolidate ML's financial statements with the financial statements of each of the affiliated investment entities.

85. Year after year, however, Defendants turned a blind eye to the substance of ML's obligations and the impact of the off-balance sheet risk created by those obligations on ML's financial statements. This lulled ML and investors, who Defendants fully understood were going to be relying upon ML's financial statements, into a false sense that ML's financial condition was much stronger than it really was. This prompted ML to continue with its business model including repurchasing troubled loans, which required significant additional borrowing by ML, without taking corrective measures to shore up its troubled financial condition. Had Defendants fully apprised ML of the true, precarious nature of ML's financial condition, it would have caused ML to alter its business strategy, to pursue a more conservative approach and to reduce its continued dependence on borrowing significant funds from Radical Bunny and others.

F. Misstatement Stemming from Defendants' Failure to Require the Proper Classification of ML's "Due From Related Party" Balance.

86. ML's balance sheet included a "due from related party" balance which was classified as an "asset" which was comprised of a loan from ML to SM Coles, LLC, which was secured by the real estate holdings of SM Coles, LLC. Between December 31, 2005 and December 31, 2006, this balance increased from $2.2 million to $48.4 million.

87. Due to the related party nature of this transaction (Scott Coles being the related party), Defendants' trained auditors knew or should have known that the presentation and disclosure of this balance on ML's financial statements was governed by specific accounting pronouncements which dictated that the proper presentation was predicated upon the form and substance of the transaction.

88. An Audit Risk Alert published by the AICPA titled *Accounting for Receivables from Owners* sets forth guidance which should have been consulted by Defendants. The Risk Alert cautions that "[t]he financial statements may be materially misstated if receivables from owners are reflected as assets. Generally, *with few exceptions*, these kinds of receivables should be reflected as a reduction in equity." The risk alert guides the auditor to get a full understanding of the substance of the transaction to determine its most proper presentation. In this regard, the Risk Alert is simply reiterating what Defendants were required to do under already existing auditing standards, including but not limited to AU § 334 pertaining to audits involving "related party" transactions or relationships. The pronouncement is clear that "the auditor should be aware that the substance of a particular transaction could be significantly different from its form and that financial statements should recognize the substance of particular transactions rather than merely their legal form."

89. Defendants' workpapers show that Defendants were actually cognizant of the issues relating to the presentation of the "due from related party" balance. In a workpaper prepared by Defendants in connection with ML's year end 2006 audit, one auditor noted:

> *Shareholder note receivable – receivable or distribution?*
>
> - Depends on the nature and intent of loan – MHM to read and include note agreement in perm file.

90. In light of the underlying substance of the transactions between ML and SM Coles, LLC, Defendants knew or should have known that both GAAS and GAAP required that the "due from related party" balance be reflected as a reduction in shareholder equity. For fiscal year-ended

December 31, 2006, this means that ML's balance sheet was materially misstated to the tune of $48.4 million -- the recorded amount of the "due from related party" asset.

91. There is no indication in any of Defendants' workpapers that Defendants ever brought this issue up to ML's Board of Directors, that any disagreement arose between Defendants and management concerning the presentation and disclosure of this issue or that any disagreement would have arisen had Defendants appropriately advised ML management to record the "due from related party" asset as a reduction in shareholder equity rather than an "asset." Of course, if an irresolvable disagreement had arisen, Defendants would have been required to issue an adverse opinion or simply have withdrawn from the audit altogether. To the contrary, ML paid Defendants to provide expertise concerning the proper application of GAAP, and Defendants promised to advise ML regarding "appropriate accounting principles and their application." There is absolutely no suggestion in ML's workpapers that management would not have heeded Defendants' advice if Defendants had appropriately advised management that the presentation and disclosure of the "due from related party" as an "asset" violated GAAP.

92. Had Defendants required that this $48.4 million "asset" be booked instead as a reduction to shareholder equity (in accordance with GAAP) as of December 31, 2006, Defendants would likely have had no choice but to issue a qualified audit report or "going concern" qualification which, in turn, would have forced ML's Board and management to make difficult (though necessary) business decisions, including but not limited to the decision to stop originating any new loans, stop incurring additional debt and potentially shutting the company down. Instead, Defendants' "clean" unqualified audit reports provided ML management with a false picture of ML's true financial health, artificially prolonged ML's existence and substantially deepened its insolvency.

G. Misstatements Stemming from Defendants' Failure to Require Consolidation of ML's Financial Statements with the Fund Entities Managed by ML.

93. GAAP, including but not limited to FIN 46, dictates that consolidation of one entity's financial statements with the financial statements of another is required when certain conditions exist. FIN 46 mandates that the financial statements of an entity are subject to consolidation when, among other things, the equity holders (e.g., investors) lack the right "to make decisions about an entity's activities that have a significant effect on the success of the entity."

94. Loans originated (and ultimately serviced) by ML were typically collateralized by an underlying piece of property. The majority of these loans were placed into pools and sold to third party investors through participation interests in limited liability companies ("LLC's") known as the MP Funds. As of December 31, 2006, there were various MP Funds including (but not limited to) the following: MP092004 LLC, MP032004 LLC, MP052005 LLC, MP122009 LLC, MP062011 LLC, MP122030 LLC, Mortgages Ltd. Opportunity Fund MP11 LLC, Mortgages Ltd. Opportunity Fund MP12 LLC, Mortgages Ltd. Opportunity Fund MP13 LLC, and Mortgages Ltd. Opportunity Fund MP14 LLC.

95. Additional loans were pooled and sold through new entities in 2007, specifically Mortgages Ltd. Opportunity Fund MP15 LLC, Mortgages Ltd. Opportunity Fund MP16 LLC, and Mortgages Ltd. Opportunity Fund MP17 LLC.

96. At year end 2006, Defendants were engaged not only to perform audits of ML, but also separate audits for each of the then-existing MP Funds. Similar to ML, Defendants issued unqualified audit reports in connection with each of those audits.

97. As reflected in Defendants' workpapers, under the terms of each of the respective operating agreements for each of the LLCs, ML served as the "managing member" of the LLC with control over the types of loans that were ultimately originated and all aspects of collection. Investors in the LLCs could vote ML out of its role as managing member, but only with a 75% majority vote.

98. In light of the fact that investors in the LLCs did not have control over the day-to-day activities relating to the loans which were sold to the LLCs and given ML management's policy to make investors whole on their investment, FIN 46 required the financial statements of each of the underlying LLCs to be consolidated with the financial statements of ML.

99. Defendants considered FIN 46 in connection with its 2006 audit, but, with respect to the mortgage pools, Defendants spent only half a page analyzing the consolidation issue and reaching the conclusion that consolidation was unnecessary. The lack of any real analysis by Defendants evidence, among, other things, Defendants' failure to exercise due care and failure to exercise "professional skepticism," an absolute requirement under GAAS.

100. Defendants' purportedly highly trained accountants failed to advise ML's Board and management that consolidation was necessary under GAAP, including the highly technical provisions of FIN 46. The result was that ML management had a skewed, incomplete picture of ML's true financial condition and the level of financial duress that ML was truly under.

101. By failing to require consolidation of the LLCs with ML, Defendants' unqualified audit reports resulted in financial statements which materially misrepresented ML's true exposure to losses related to the impairment of the "off balance sheet" loans (discussed above) and ML's true, dire liquidity position. Had Defendants advised management to consolidate ML's financial statements in accordance with GAAP and the promises made in their engagement letters, Defendants would undoubtedly have been left with no choice but to issue a qualified audit report in connection with its 2006 audit, if not earlier. Instead, apparently bent on continuing to milk fees out of ML and the various affiliated entities for which they performed distinct audits, Defendants issued a clean unqualified audit report on ML's financial statements which resulted in the origination of more loans and even more losses, driving ML deeper and deeper into insolvency.

H. Under GAAS, Defendants Were Required to Qualify or Disclaim their Audit Reports Because, Among Other Things, Defendants Knew or Should Have Known that Defendants Did Not Have Sufficient Competent Evidential Matter Upon Which to Base their "Clean" Opinions.

102. GAAS requires that the auditor issue a report expressing an opinion as to the financial statements under audit or an assertion to the effect that an opinion cannot be expressed. When an opinion is not expressed, the auditor is required to state the reasons therefore.

103. As expressed in AU § 508.03, the auditor's justification for expression of an opinion "rests on the conformity of his audit with generally accepted auditing standards." Stated differently, if an auditor knows or should know that he has not performed an audit in accordance with GAAS, the auditor is required to not express an opinion.

104. As expressed in AU § 508.14 (effective at the time Defendants conducted the ML audits), under GAAS, an auditor shall not express an opinion or state that the financial statements present fairly in accordance with GAAP if the auditor believes the statements contain a departure from any accounting principle.

105. As expressed in AU § 508.20, under GAAS, an auditor is required to qualify its audit report when "there is a lack of sufficient competent evidential matter or there are restrictions on the scope of the audit that have led the auditor to conclude that he cannot express an unqualified opinion," or when the auditor believes "that the financial statements contain a departure from GAAP."

106. As expressed in AU § 508.24, under GAAS, "when restrictions that significantly limit the scope of the audit are imposed by the client, ordinarily the auditor should disclaim an opinion on the financial statements."

107. As expressed in AU § 341, under GAAS, an auditor is also required to evaluate "whether there is substantial doubt about the entities ability to continue as a going concern for a

reasonable period of time" and if the auditor concludes that such doubt exists, it is required to place an explanatory paragraph in its report to reflect such a conclusion.

108. As set forth more fully herein, Defendants misrepresented that Defendants had conducted the ML audits in accordance with GAAS and that ML's financial statements were fairly stated in accordance with GAAP. This was simply false. Defendants' clean audit reports left ML's Board and management with a serious misimpression as to ML's true financial condition and the false belief that ML's future cash flows would be sufficient to meet ML's obligations when, in fact, ML was facing a significant liquidity crunch which would only worsen with time.

109. Defendants' utter failure to perform a going concern analysis in connection with their audit of ML's financial statements for the fiscal year ended December 31, 2006 is particularly disturbing given that Defendants had performed the analysis a year earlier when the deficit in ML's net current assets was almost $40 million smaller. Indeed, there is no memorandum in the 2006 audit documentation similar to that of the "Summary of Risks and Uncertainties" memo included in Defendants' 2005 audit workpapers. Instead, Defendants' 2006 audit workpapers summarily conclude "no going concern issue."

110. It appears that Defendants looked past the widening deficits and the need to perform a going concern analysis based upon flawed (many times baseless) conclusions which were the product of a flawed audit. For example, it appears that the lack of a going concern analysis was driven, at least in part, upon Defendants' incorrect conclusion that ML's "mortgage investments" were appropriately valued without any reserve whatsoever and their further conclusion that the $48 million "due from related party" asset was greater than the deficits when, in fact, GAAP dictated that this balance should not have been reflected as an asset at all but rather as a reduction to equity.

111. A detailed going concern analysis was also critical in view of the headwinds documented in Defendants' workpapers. For example, Defendants fully understood that ML's

business was extremely sensitive to changes in the economic conditions, and in connection with their 2005 audit, even documented its belief that the economy was slowing. As reflected in Defendants' workpapers, Defendants also understood that commercial bank lenders were beginning to tighten their underwriting standards in the wake of the slowing economy. Defendants' workpapers reflect Defendants' belief that this environment actually created business opportunity for ML who provided an alternative source of financing to developers. Defendants, however, knew or should have known that ML could only take advantage of this "opportunity" by taking on additional debt, originating more loans, and keeping its current investors happy.

112. GAAS required Defendants to "look under the hood" and perform a careful analysis of ML's true financial position. Indeed, any reasonable auditor in Defendants' position with the facts known to Defendants would have performed an in-depth going concern analysis by, among other things, measuring their client's future liquidity based upon varying assumptions. No such analysis was performed.

113. Under GAAS, by December 31, 2006 at the latest, Defendants were required to qualify their audit reports with an explanatory "going concern" paragraph or, alternatively disclaim their opinion and withdraw if any disagreement arose as to the necessity of a going concern qualification. Instead, clearly influenced by a lack of independence and professional skepticism, as set forth herein, Defendants issued an unqualified audit report which perpetuated and deepened ML's insolvency by no less than $100 million.

I. Defendants Misrepresent to ML that they Performed GAAS Audits and that ML's Financial Statements were Fairly Stated in Accordance with GAAP.

114. Throughout the course of their audits, Defendants made numerous representations to the ML and its Board of Directors which reinforced the belief that ML was financially sound.

115. In connection with each of their audits of ML's financial statements for the fiscal years ended 2004 through 2007, Defendants issued clean or unqualified audit reports. In

Defendants' "Independent Auditors' Report" dated December 9, 2005 for the period ended October 31, 2005, Defendants made the following representations to ML's Board of Directors:

> We have audited the accompanying balance sheets of Mortgages , Ltd at October 31, 2005 and 2004, and the related statements of income and retained earnings and cash flows for the years then ended…
>
> ***We conducted our audits in accordance with U.S. generally accepted auditing standards.*** Those standards require that we plan and perform our audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. ***An audit also includes assessing the accounting principles used and significant estimates made by management***, as well as evaluating the overall financial statement presentation…
>
> ***In our opinion, the financial statements referred to above present fairly…the financial position of Mortgages Ltd. at October 31, 2005 and 2004, and the results of operations and its cash flows for the years then ended in conformity with U.S. generally accepting accounting principles.***
>
> Mayer Hoffman McCann, P.C.
>
> Phoenix, Arizona
> December 9, 2005

116. The same or substantially the same representations were made by Defendants to ML's Board of Directors in their audit reports dated March 26, 2007 and March 28, 2008 issued in connection with Defendants' audits of ML's consolidated financial statements for the periods ended December 31, 2006 and December 31, 2007. Similarly, the same or substantially the same representations were made by Defendants' in their audit reports issued in connection with each of the MP Funds at the conclusion of Defendants' 2006 audit.

117. Defendants knew or should have known that each of the representations made to ML's Board of Directors in each of their audit reports was false for various reasons including, but not limited to, the following:

- Defendants knew or should have known that they did not perform an audit in accordance with GAAS;

- Defendants knew or should have known that they did not properly assess and evaluate the accounting principles and significant estimates being used by management as described herein even though Defendants fully understood that ML management lacked GAAP financial reporting expertise;

- As set forth herein, Defendants knew or should have known that ML's financial statements were not fairly presented in accordance with GAAP but, in violation of GAAS, Defendants never disclosed this to ML's Board of Directors; and

- Defendants knew or should have known that ML's financial statements were, in fact, materially misstated. By way of example, as set forth herein, Defendants knew or should have known that ML's financial statements were materially misstated as a result of ML's failure to properly record reserves on impaired mortgage investments and also knew or should have known that certain balances were improperly classified, including the $48.4 million due from related party balance which Defendants knew or should have known was improperly classified as an "asset" on ML's balance sheet in violation of GAAP.

118. As set forth in AU § 508, Defendants also violated GAAS by issuing its "unqualified" audit reports when Defendants knew or should have known that they did not, in fact, perform an audit in accordance with GAAS and that ML's financial statements were materially misstated and did not conform with GAAP.

119. As set forth in AU § 508.14: "A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data are presented in conformity with [GAAP]...if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles that has a material effect on the statements taken as a whole."

120. As a result of Defendants' misconduct and their multiple GAAS violations, ML's annual audited financial statements for each of the years ended 2005 through 2007 (and the MP Funds), were materially misstated in that, among other things:

- As discussed herein, Defendants knew or should have known that ML's reported asset values and income for these periods was materially overstated as a result of Defendants' failure to require any reserve whatsoever with respect to ML's

mortgage investments and real estate and improvements held for sale despite the conservatism required by GAAP; and

- Defendants knew or should have known that the disclosure in the Notes to ML's financial statements that "the estimated fair market value of the collateral is typically in excess of the loan balances on loans held for sale" was materially false and misleading in that, among other things, Defendants often ignored the impaired status of these "investments," the declining economy and the underlying loan terms which often included additional future funding obligations which could and did in many cases exceed the value of the collateral.

121. Defendants knew or should have known that ML's Board of Directors were foreseeable user of the companies' respective financial statements and would reasonably and justifiably rely upon ML's audited financial statements and the audited financial statements of the MP Funds as well as the representations made by Defendants in each of their audit reports, and Defendants intended such reliance.

122. Defendants' unqualified audit reports left ML's Boards of Directors and management with the gross misimpression that ML's financial statements were fairly presented in accordance with GAAP when this was simply not the case.

IV. AS A DIRECT RESULT OF DEFENDANTS' WRONGFUL CONDUCT ML SUFFERS MASSIVE FINANCIAL LOSS INCLUDING (BUT NOT LIMITED TO) THE DEEPENING OF ITS INSOLVENCY.

123. Defendants' audits of ML's financial statements demonstrate a remarkable lack of due care and a failure by Defendants to really gain an understanding of ML's business and the risks associated with it. As a result, ML management had an inaccurate understanding of ML's true financial health, and made business decisions based upon that inaccurate understanding.

124. The result of Defendants' numerous audit failures was to prolong ML's existence despite its insolvency. Had Defendants discharged their professional duties in accordance with GAAS, ML and the MP Funds would have been forced to cease or significantly alter their operations by as early as December 31, 2005, thereby avoiding the deepening of ML's insolvency (as well as

the MP Funds) and the concomitant consumption of ML's existing assets that would not have occurred had ML shut down and/or drastically altered its business in a timely manner.

125. For example, ML's debt continued to grow throughout 2007. By the end of the year, ML had a balance of $181 million in outstanding notes payable which was an increase of approximately $35 million from the prior year. During this same time, ML re-acquired underperforming loans with increasing frequency and ML's "Beneficial Interests in Mortgage Investments," which was money ML borrowed and was committed to repay as a part of its Revolving Opportunity Loan Program, expanded by over $100 million from $50.1 million to $151.4 million.

126. Had Defendants discharged their professional duties, ML and the MP Funds would have been forced to shut down or to dramatically alter its business such that these, and other obligations, could have been and would have been avoided. Instead, Defendants' wrongful conduct as described herein drove ML deeper into insolvency and resulted in damages totaling no less than $100 million.

COUNT I

(Accounting Malpractice/Professional Negligence)

127. Paragraphs 1 through 126 of this Complaint are incorporated into this Count as if fully set forth herein.

128. Defendants owed ML a duty to exercise due professional care in the conduct of their audits of ML's financial statements which included, among other things, the duty to perform their audits in accordance with generally accepted auditing standards.

129. Defendants' conduct fell below and breached the level of the professional duty of due care that they owed to ML. As set forth more fully herein, Defendants' conduct fell below the standard of care in at least the following respects, among others:

- Defendants lacked independence;

- Defendants failed to properly plan each of their audits;
- Defendants failed to increase the scope of their audits and pursuit of competent evidential matter despite ML's huge growth and despite having undertaken the audits with knowledge that ML's accounting personnel lacked GAAP expertise.
- Defendants ignored red flags which should have alerted Defendants' trained auditors to potential going concern issues;
- Defendants knew or should have known that the financial statements of ML and the MP Funds were prepared with material departures from GAAP which caused those financial statements to be materially misstated, but Defendants issued unqualified audit reports anyway.

130. Defendants' professional negligence continued throughout their representation of ML, from their engagement in 2004 through the clean, unqualified audit report issued months before ML fell into bankruptcy.

131. Defendants' professional malpractice ultimately led ML to sustain substantial damages.

132. Defendants' negligence was the direct and proximate cause in fact of ML's injuries.

133. Defendants' negligence was the legal and proximate cause of ML's injuries.

134. As a direct and proximate result of Defendants' malpractice as described herein, ML sustained substantial damage in an amount to be determined at trial, including but not limited to the deepening of ML's insolvency.

COUNT II
(Negligent Misrepresentation)

135. Paragraphs 1 through 134 of this Complaint are incorporated into this Count as if fully set forth herein.

136. At the conclusion of each of their audits for fiscal years 2004 through 2007, Defendants in the course of their business, issued an audit report specifically addressed "to the Board of Directors and Stockholder" of ML as well as to the "Board of Directors and Members of the MP Funds."

137. As set forth herein, in each of their audit reports Defendants represented, among other things, that they had "conducted [the] audits in accordance with U.S. generally accepted auditing standards" and that "the financial statements...present fairly...the financial position of Mortgages Ltd [and each of the MP Funds] in conformity with U.S. generally accepting accounting principles." These statements were false and negligently made.

138. As set forth herein, Defendants failed to exercise reasonable care in obtaining and communicating the information contained in each of their audit reports.

139. Defendants intended the information in each of their audit reports to reach ML's Board of Directors (and the Board of Directors and members of the MP Funds and) and reasonably expected that such persons would receive and rely on the information in Defendants' clean audit reports in making business decisions. ML, its Board of Directors as well as the Board of Directors and members in the MP Funds were expected to rely on Defendants' audit reports and the accompanying financial statements.

140. ML, its Board of Directors and members of ML Management (as well as the Board of Directors and members of the MP Funds) in fact, reasonably and justifiably relied upon false statements and information contained within each of Defendants' audit reports.

141. ML suffered substantial damages as a result of Defendants' negligent misrepresentations, including the deepening of its insolvency.

COUNT III
(Breach of Contract)

142. Paragraphs 1 through 141 of this Complaint are incorporated into this Count as if fully set forth herein.

143. As set forth herein, in connection with each of their audits, Defendants provided an engagement letter directed to ML's Board of Directors in which Defendants promised, among other

things, the following: (a) that they would conduct their audits of ML's financial statements in accordance with GAAS; (b) that they would perform tests of the documentary evidence supporting the transactions recorded in ML's accounts; (c) that they would examine evidence supporting the amounts and disclosures in the financial statements of ML; and (d) that they would advise ML about appropriate accounting principles and their application.

133. As set forth herein, Defendants breached the aforesaid contractual duties they owed to ML by failing to perform in accordance with each of the express promises that they made in Defendants' engagement letters.

134. As a result of Defendants' breach of contract as described herein, ML sustained substantial damage in an amount to be proven at trial.

WHEREFORE, Plaintiff prays for judgment against Defendants as follows:

A. For actual damages in excess of the jurisdictional limit of this Court in an amount to be proven at trial;

B. For pre-judgment and post-judgment interest as allowed pursuant to Arizona statutory and common law;

C. For exemplary damages;

D. For the Plaintiff's taxable costs and expenses of litigation;

E. Disgorgement of profits as allowed by law; and

F. Such further equitable or other relief as the Court deems appropriate under the circumstances.

V. JURY DEMAND.

Plaintiff hereby demands a jury for the trial of this action.

RESPECTFULLY SUBMITTED this 26th day of August, 2010.

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