

# EXHIBIT 2 PART 2

1 language in the governing documents that gave him discretion to reject redemption  
2 requests.

3         213. Mortgages Ltd.'s inability to honor redemption requests coincided with  
4 defaults by borrowers on millions of dollars in maturing loans. By at least mid-January  
5 2008, Greenberg knew that the borrowers on over \$100 million in development loans that  
6 Mortgages Ltd. had funded had defaulted. Greenberg knew this because attorneys in its  
7 real-estate and bankruptcy departments (Karl Freeburg, Julie Rystad, and John  
8 Clemency) prepared default notices for Mortgages Ltd. to send to the borrowers who had  
9 given notice that they would not pay upcoming payments.

10         214. One borrower for which Greenberg prepared a default notice was known as  
11 the Grace Capital or Vento Group. The default letter that Greenberg prepared noticed a  
12 default on loans with an outstanding principal balance of over \$100 million. At the time  
13 of default, the Grace (Vento) loans were impaired by about \$60 million. *See infra* ¶ 375.  
14 No disclosure of the impairment was made in the Company's POM or its audited 2007  
15 financial statements.

16         215. Another borrower for which Greenberg prepared a \$37 million default  
17 notice in January 2008 was Central Phoenix Partners, LLC, a developer whose property  
18 had been in foreclosure in early 2007. At the time of default notice, the loan was  
19 impaired by about \$6.6 million (*see infra* ¶ 375), but no disclosure of the impairment or  
20 earlier foreclosure was made in the Company's POMs or its audited 2007 financial  
21 statements.

22         216. Mortgages Ltd.'s inability to honor redemption requests, also overlapped  
23 with (a) Coles' instructions to Defendant Olson to call Radical Bunny once a day to see if  
24 it had new money to loan and (b) Mortgages Ltd.'s inability to pay Greenberg's own bills  
25 as they became due.

26         217. In the midst of this financial turmoil, Kant prepared POMs for two new

1 2008 offerings. These new POMs, like the earlier POMs prepared by Kant, failed to  
2 disclose:

- 3 • The risks associated with the re-written and extended loans;
- 4 • The risks associated with the increasing concentration of mega-  
5 loans;
- 6 • The risks associated with Mortgages Ltd.'s inability to fund loan  
7 commitments;
- 8 • That Mortgages Ltd. had ceased its core business operations and no  
9 longer had the financial capacity to make new loans; or
- The growing defaults on the loans held by Mortgages Ltd.

10 **3. Greenberg helped Mortgages Ltd. cover-up the**  
11 **Company's fraud by creating a new product.**

12 218. One offering involved a new product that Kant helped structure. The new  
13 product was known as the Value-to-Loan Opportunity Fund (VTL Fund). It was  
14 marketed under a POM dated January 28, 2008 that Kant prepared.

15 219. The VTL Fund was a direct result of Mortgages Ltd.'s insolvency, i.e., its  
16 inability to pay its interest obligations and other debts as they become due. Kant and  
17 Mortgages Ltd. created the Fund at the same time Olson was making daily calls to  
18 Radical Bunny to see if it had new money to loan. Kant formed the Fund in violation of  
19 voting requirements in operating agreements under which Mortgages Ltd. was managing  
20 existing LLCs.

21 220. The VTL Fund was formed to borrow more money (on top of the \$131  
22 million already owed Radical Bunny investors)<sup>12</sup> that could be loaned by the VTL Fund  
23 to the LLCs (MP Funds) listed in Exhibit A. In addition to the non-disclosures described  
24 in earlier paragraphs, the VTL Fund offering documents did not disclose that millions of  
25 dollars to be raised under the VTL offering were earmarked to fund impound accounts

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<sup>12</sup> At December 31, 2007, Mortgages Ltd. owed Radical Bunny \$131 million.

1 through which interest to existing Mortgages Ltd. investors would be paid.

2 221. Through the creation of the VTL Fund, Kant helped mask the Company's  
3 insolvency by raising new money that had nothing to do with loan originations.

4 222. Through the VTL Fund, Mortgages Ltd. raised over \$7 million. More than  
5 55% of the money was used to fund impound accounts for interest owed by developers  
6 who had previously borrowed money from Mortgages Ltd. Nearly all of these developer  
7 loans were troubled loans that had been rewritten during a period of falling real-estate  
8 prices. Mortgages Ltd. used money in the impound accounts to pay interest on money  
9 owed to earlier Mortgages Ltd. investors. In short, the VTL Fund was largely created to  
10 raise money from new investors to pay old investors.

11 223. Kant was aware of Mortgages Ltd.'s inability to pay its debts as they came  
12 due (see, e.g., ¶¶ 213-15, 227, and 233-35) and of its dependence on Radical Bunny's  
13 tainted funds (see, e.g., ¶¶ 202-03, 226-27, and 233-35). By preparing the documents  
14 needed to create and sell the VTL Fund, Kant and Greenberg knowingly participated in  
15 Mortgages Ltd.'s ongoing fraud and helped the Company cover-up its fraud.

16 **4. Greenberg helped Mortgages Ltd. cover-up the**  
17 **Company's fraud by advising it that disclosure on**  
18 **the Company's inability to meet loan commitments**  
**was not needed.**

19 224. As the Company's financial crisis worsened in 2008, Mortgages Ltd.  
20 employees began to abandon the sinking ship.

21 225. Newman, who Kant had recruited for the Company, resigned in mid-2007.

22 226. From late 2006 through 2007, Denning and Brown had participated in the  
23 meetings, telephone conversations, and written communications regarding Radical  
24 Bunny's securities violations. Both men knew that Mortgages Ltd.'s ability to operate  
25 depended on illegal money for which that they heard Kant say people go to jail. By  
26 December 2008, Denning and Brown were fearful to the point that they had decided to

1 resign. Kant was aware of their resignations and had discussed their concerns about  
2 Radical Bunny with them.

3 227. On January 15, 2008, Coles and Nechelle Wimmer, a Mortgages Ltd.  
4 officer, met with Kant to discuss Mortgages Ltd.'s funding obligations under its loan  
5 commitments. During this meeting, Coles asked Kant if they were required to disclose to  
6 Mortgages Ltd.'s investors that the Company was having difficulty meeting its funding  
7 obligations. Kant said "no."

8 **5. Greenberg helped Mortgages Ltd. terminate an**  
9 **insider who attempted to blow the whistle on the**  
10 **Company's fraud.**

11 228. Robert Furst was a broker who worked for Mortgages Ltd.'s captive  
12 securities broker, ML Securities. Furst was also licensed as an attorney.

13 229. Through his work, Furst learned about defaults by Mortgages Ltd. on loans  
14 to its borrowers. He was also aware that Mortgages Ltd. was borrowing money from  
15 Radical Bunny. He had heard about the securities violations through which Radical  
16 Bunny was raising its money.

17 230. In December 2007, Furst raised concerns with his supervisor about  
18 Mortgages Ltd.'s defaults on obligations to its investors and borrowers. In March 2008,  
19 Furst raised additional concerns about Mortgages Ltd.'s business practices with Coles  
20 and others.

21 231. That same month, Mortgages Ltd. contacted Greenberg about Furst's  
22 concerns. Kant and a Greenberg employment partner named John Lomax evaluated the  
23 issues and advised Mortgages Ltd. on how to respond.

24 232. At Lomax's direction, Greenberg advised Mortgages Ltd. to inform Furst  
25 that he should not be making baseless allegations. Greenberg also approved a decision to  
26 suspend Furst with pay. The suspension was implemented on March 31, 2008.

233. The next day, April 1, 2008, Furst sent an e-mail to Mortgages Ltd. that

1 was forwarded to Lomax at Greenberg the same day. In his e-mail, Furst responded to a  
2 request from Mortgages Ltd. for a list of his allegations. In response, Furst's April 1 e-  
3 mail listed 14 investor or disclosure issues that needed to be addressed, namely:

- 4 1. Revolving opportunity program investors who are victims of a  
5 default by Mortgages Ltd.
- 6 2. Capital opportunity program investors who are victims of a default  
7 by Mortgages Ltd.
- 8 3. Mortgages Ltd./Radical Bunny securities issues
- 9 4. Mortgage pool investors disclosure issues
- 10 5. Value-to-loan fund disclosure issues
- 11 6. Investors who did not grant discretion to Mortgages Ltd.
- 12 7. Investors who wanted to receive their 2007 reinvested interest but  
13 did not receive it
- 14 8. Mortgages Ltd. 401(k) plan participant issues
- 15 9. Broker dealers and registered investment advisors disclosure issues
- 16 10. Solvency issues of Mortgages Ltd.
- 17 11. Loan summary sheets and related disclosure issues
- 18 12. Borrowers who are victims of a default by Mortgages Ltd.
- 19 13. Loan workouts questioned by investors
- 20 14. Discrimination in treatment among investors by Mortgages Ltd.

21 234. On April 8, 2008, Furst and his attorney met with Kant and Lomax to  
22 discuss the issues Furst listed. The meeting was unproductive.

23 235. Rather than address Furst's concerns—which Kant knew from his own  
24 work were legitimate—Kant and Lomax mapped a plan for Mortgages Ltd. to fire Furst.  
25 Furst was fired on April 25, 2008.

26 236. On April 28, 2008, a securities attorney from Snell & Wilmer representing  
Furst sent Lomax a letter. In the letter, the Snell & Wilmer partner explained that Furst

1 had been fired in retaliation for his decision to disclose Mortgages Ltd.'s securities  
2 violations. One of the disclosure violations that was listed was Mortgages Ltd.'s  
3 "potential complicity in the securities offerings to Radical Bunny's investors."

4 237. The letter from the Snell & Wilmer partner concluded: "Although your  
5 client seemed to have no interest in hearing (let alone resolving) these issues and others  
6 which Mr. Furst either brought, or attempted to bring, to Mr. Cole's attention, they will  
7 undoubtedly be of interest to the Arizona Securities Division and other regulators."

8 238. In a regulatory filing made to explain why Furst was fired, ML Securities  
9 gave the following reason: "[w]e learned that he may not be well suited to continue  
10 working for us. For example, it appears he may have misrepresented his credentials."  
11 Greenberg, with Kant's approval, drafted this language.

12 239. Kant knew that Furst's concerns were legitimate. For example, Furst was  
13 concerned about Radical Bunny's securities violations. Kant had himself expressed  
14 concern about these same violations since at least December 2006—15 months before  
15 Furst raised the issue. Kant had gone so far as to say that Hirsch could go to jail for  
16 Radical Bunny's securities violations and that both Hirsch and Coles could end up on the  
17 front page of the Arizona Republic. Likewise, Kant knew that Furst's concerns about  
18 loan defaults and Mortgages Ltd.'s solvency were legitimate issues. He knew that  
19 Greenberg attorneys were assisting Mortgages Ltd. on workout issues and had noticed  
20 defaults on over \$100 million in loans due from developers. And he knew that by  
21 November 2007, or earlier, that Mortgages Ltd. had stopped paying Greenberg's fees. In  
22 December 2007, he sent a series of e-mails to Denning and Brown pressing for payment.  
23 In January 2008, he negotiated a workout on the fees under which Mortgages Ltd. agreed  
24 to pay \$50,000 a month on past due balances.

25 240. In this regard, Plaintiffs have examined the Company's 2008 records  
26 regarding deposits of money from Radical Bunny and payments to Greenberg. Those

1 records show that during 2008, Greenberg accepted over \$268,000 in fees paid by checks  
2 issued within one day of money borrowed from Radical Bunny being deposited.  
3 Throughout this period, Defendant Olson was making daily calls to Radical Bunny to see  
4 if money could be borrowed. In addition to the 2008 fees made possible by Radical  
5 Bunny's loans, Kant agreed to accept \$20,000 in tainted money from Radical Bunny in  
6 return for preparing Radical Bunny's private-offering memorandum.

7 241. Although Furst's 14-point e-mail raised material disclosure issues, Kant  
8 took no action to amend or supplement the POMs that he had prepared to disclose  
9 Mortgages Ltd.'s inability to pay its debts as they became due or the tainted Radical  
10 Bunny funds on which Mortgages Ltd.'s survival depended.

11 242. Despite his knowledge of the ongoing fraud, Kant until the end continued  
12 to devise ways to extend the deception. On May 29, 2008, just days before Coles' death,  
13 Kant sent Coles a message encouraging him to continue what Kant knew was a  
14 fraudulent enterprise:

15 Scott, I had a meeting with my team . . . . We have a plan,  
16 which I want to discuss with you. I did want you to know  
17 that everyone at the meeting had nothing but great things to  
18 say about you, including how smart you are and how hard  
19 you are working to protect your investors. We do not always  
20 see that in situations like this. Let's chat.

21 243. In May 2008, when Kant sent this note, he had assembled a team of  
22 Greenberg attorneys to handle regulatory inquiries about Mortgages Ltd. and Radical  
23 Bunny's activities that were anticipated or underway by the Financial Industry  
24 Regulatory Authority, the Securities and Exchange Commission, the Arizona Securities  
25 Division, and the Arizona Department of Financial Institutions.

26 244. During these regulatory inquiries, Kant and Greenberg insisted that  
Mortgages Ltd. was blameless.

245. In June 2008, when Mortgages Ltd. was forced into involuntarily



1 bankruptcy, Greenberg attempted to control public disclosures by filing a petition for a  
2 voluntary bankruptcy reorganization.

3 246. Even after creditors filed bankruptcy objections explaining that Greenberg  
4 was really defending its own conduct, Greenberg persisted in trying to control the  
5 bankruptcy in a series of heated bankruptcy hearings. Eventually, pressure from creditors  
6 forced Greenberg to resign.

7 **b. Quarles' role in the fraudulent scheme and illegal securities**  
8 **sales.**

9 247. As alleged above, Moya, Hoffmann, and Bornhoft quickly realized that  
10 Radical Bunny was selling securities in violation of Arizona and federal securities laws.  
11 Hoffmann also suspected that the co-venture between Mortgages Ltd. and Radical Bunny  
12 was a Ponzi scheme.

13 248. After his first conversation with Hirsch on January 25, 2007, Moya wrote  
14 an e-mail to his partner Hoffmann, in which Moya explained that Radical Bunny was  
15 concerned with securities-compliance issues and stated, "I can see why."

16 249. Reviewing Radical Bunny's files, Hoffmann saw loan lists showing that  
17 Mortgages Ltd. had never repaid any of the principal that was borrowed. For example,  
18 Radical Bunny provided Quarles with a March 1, 2007 loan list showing that \$144.5  
19 million had been borrowed as of that date, but none of the principal had been repaid.  
20 Hoffmann knew from his discussions with Hirsch that the loans that led to this \$144.5  
21 million had begun in 2005.

22 250. As an experienced, 25-year securities lawyer, Hoffmann was familiar with  
23 Ponzi schemes. Because of the continuing rollover of money without any payment of  
24 principal, Hoffmann questioned whether Mortgages Ltd. was operating a Ponzi scheme  
25 fueled by funding from Radical Bunny's securities sales. On March 22, 2007, he made a  
26 file note asking, "[A] Ponzi scheme feel?" When asked by the SEC to explain this

1 reference to a Ponzi scheme, Hoffmann acknowledged that it was a serious concern:

2 Q. But something prompted you to raise that  
3 question. I'm trying to find out what that was.

4 A. Well, we were talking among ourselves and  
5 raising issues, and so the -- if you see a few lines earlier, do  
6 we ever -- oh, how do our investors reinvest, and do they ever  
7 send money back to us, meaning does Mortgages Limited  
8 ever send money back to us? So I'm raising these questions.  
9 Therefore, if they never send money back to us other than  
10 interest, does that have a Ponzi scheme feel to it.

11 Q. A serious concern?

12 A. Yes.

13 Despite the admitted seriousness of the issue (and with willful blindness to the existence  
14 of the scheme), Hoffmann and the other Quarles attorneys continued representing Radical  
15 Bunny in its loans to Mortgages Ltd. until after Coles died. The result was some \$200  
16 million in preventable losses by both Mortgages Ltd. and Radical Bunny investors.

17 251. In short order, Quarles concluded that the Radical Bunny sales of loan  
18 participation interests to investors, many of whom were unaccredited, involved securities  
19 registration and disclosure violations. In a conversation with Kant on May 3, 2007,  
20 Hoffmann, Moya, and Bornhoft discussed these securities violations and the need to  
21 remedy them. This was no surprise to Kant. As Kant later told the SEC, he didn't see  
22 how an experienced securities attorney could reach any other conclusion.

23 252. Quarles also quickly realized that, contrary to what Radical Bunny had  
24 been telling its investors, its notes from Mortgages Ltd. were *not* secured. Mortgages  
25 Ltd. had never signed a security agreement in favor of Radical Bunny. Nor did the  
26 promissory notes evidencing the loans refer to any collateral that secured repayment.  
Rather than reveal the false representation of security to investors, Quarles tried to  
address the problem without disclosure. Thus, in April 2007, Quarles attorney Bornhoft  
prepared a Term Sheet outlining a loan program in which Radical Bunny's loans would

1 become secured as represented to its investors.

2 253. Moya and Bornhoft were previously sued by a non-client (David Kremser)  
3 for allegedly failing to properly perfect a security interest. In that case, the Arizona Court  
4 of Appeals held that Quarles had a duty to properly perfect the security interest even  
5 though the plaintiff was not a client of the firm.<sup>13</sup> Because of the Kremser litigation,  
6 Moya and Bornhoft were especially sensitive to the materiality of the failure to perfect  
7 the security interest represented to Radical Bunny's investors.

8 254. As alleged above (¶ 153), on May 2, 2007, Hoffmann purportedly told  
9 Hirsch and the other Radical Bunny managers that they had to stop selling securities,  
10 disclose their securities violations to the SEC and Arizona Securities Division, and  
11 comply with the securities-registration statutes before any new sales occurred.

12 255. Hirsch told the Quarles lawyers that Radical Bunny would not agree to  
13 admit and disclose the past securities violations. *See supra* ¶¶ 22, 154-55. Hoffmann  
14 later testified to the SEC that he and the other Quarles lawyers assumed that Radical  
15 Bunny would at least stop the illegal securities sales, thereby acknowledging that it would  
16 be improper for Quarles to continue representing Radical Bunny with knowledge that its  
17 client was continuing to sell investments in violation of the Arizona and federal securities  
18 laws. But as alleged above (¶¶ 23, 155-85) and further explained below, that is exactly  
19 what Quarles proceeded to do.

20 256. Quarles attorneys Hoffmann, Moya, and Bornhoft knew that Radical Bunny  
21 was continuing to sell securities in violation of the securities laws. *See supra* ¶¶ 155-85.  
22 But rather than withdraw from further representation, they participated in, induced, and  
23 substantially assisted Radical Bunny (and, in turn, the ML-RB Joint Venture) in  
24 perpetrating the illegal loan program through which Class members were defrauded.

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26 <sup>13</sup> *See Kremser v. Quarles & Brady, L.L.P.*, 201 Ariz. 413, 36 P.3d 761 (App.  
2002).

**1. Quarles participated in the ongoing unlawful securities sales.**

257. In May of 2007, with full knowledge of Radical Bunny's unlawful securities sales, Quarles began working with Greenberg (Kant) to prepare a Radical Bunny private-offering memorandum to replace the materially incomplete and misleading Directions to Purchase that Quarles knew Radical Bunny had been using.

258. Quarles attorneys Hoffmann and Shullaw began planning a private-offering memorandum to be used in continuing sales to Radical Bunny investors. Shullaw notified Radical Bunny on May 8, 2007 that he had "begun work on a participation agreement to be used in lieu of your direction to purchase." Pending completion of the new participation agreement, however, Radical Bunny needed advice on what risk disclosures should be made to its new investors.

259. In mid-May 2007, Quarles drafted and sent to Hirsch interim risk-disclosure language and other documents that could be used with new investors. Shullaw sent some of those documents to Radical Bunny on May 23, 2007, together with a "process summary to be used for *new* investors." (Emphasis added). Quarles thus knew that Radical Bunny was continuing sales to new investors. Radical Bunny revised its investor forms to incorporate the risk-disclosure language that Quarles drafted.

260. But the language Quarles drafted for new sales was itself misleading. The new risk disclosures falsely represented that the investments being sold by Radical Bunny were secured with a lien on the assets of Mortgages Ltd. Quarles knew that no such security existed and that Mortgages Ltd. had balked at providing collateral to secure its growing debt to Radical Bunny. The Quarles' risk-disclosure language also failed to reveal that Radical Bunny's prior sales violated the securities laws (even though Hoffmann supposedly had told Hirsch that Radical Bunny needed to make this corrective disclosure to existing investors). Nor did the Quarles documents disclose the risks and

1 contingent liabilities associated with the illegal securities sales.

2       261. After being told by Quarles, in early May 2007, that Radical Bunny was  
3 violating the securities laws, Hirsch, the Walders, and Shah sought advice from Quarles  
4 attorneys (including Hoffmann and Bornhoft) on the annual investor meeting scheduled  
5 for later that month at the Orange Tree Resort. Hirsch explained that all Radical Bunny  
6 investors would be invited. He explained to the Quarles attorneys that multiple  
7 presentations would be made over a three-day period so that all investors would have a  
8 chance to attend.

9       262. Hirsch told the Quarles attorneys that the purpose of the meeting was to  
10 update investors on Radical Bunny's status. Quarles advised Hirsch and his partners how  
11 to conduct the meeting. Quarles recommended controlling the persons who attended the  
12 May 2007 investor meeting by having Radical Bunny require admittance tickets. The  
13 Quarles attorneys also discussed with Hirsch what would be said to the investors. In  
14 these discussions, Quarles agreed that Hirsch could tell the investors that Radical Bunny  
15 was being represented by Quarles on securities issues and that a new investment program,  
16 prepared and approved by Quarles, would be forthcoming.

17       263. Hoffmann, Moya, and Bornhoft knew that Hirsch would make no  
18 disclosure at the May meeting of Radical Bunny's past securities violations including the  
19 misrepresentation that Radical Bunny's loans were secured by all of Mortgages Ltd.'s  
20 assets. The Quarles attorneys knew this because Hirsch had already told Hoffmann,  
21 Moya, and Bornhoft on May 2, 2007 that he was not willing to admit to securities  
22 violations.

23       264. Quarles also knew that Hirsch and Radical Bunny intended to continue  
24 selling new investments and that, because investors who attended the annual meeting had  
25 historically reinvested with Radical Bunny, the meeting participants would inevitably be  
26 purchasing or reinvesting in Radical Bunny securities.

1           265. From June through December 2007, Moya, Shullaw, and Bornhoft, and to  
2 some extent Hoffmann, worked with Kant in preparing loan documents and continuing  
3 work on a private-offering memorandum. On July 26, 2007, Quarles attorney Shullaw  
4 reviewed “new materials being used by Radical Bunny,” and on July 31, 2007, he  
5 discussed with Hoffmann the status of the review of Radical Bunny’s “new offering  
6 documents.” On August 1, 2007 Shullaw forwarded to Hoffmann the “materials  
7 currently being used” along with a “summary of securities issues.”

8           266. As explained above (see ¶¶ 161-64), a meeting was held on August 13,  
9 2007. At that meeting, Kant told Hirsch, in the presence of Moya and Bornhoft, that  
10 Hirsch could go to jail for Radical Bunny’s securities violations. During the meeting,  
11 Kant, Moya, Bornhoft, Denning, and Hirsch then discussed a new plan under which  
12 Radical Bunny’s notes would be converted to LLC interests and sold under a POM of the  
13 type used for the limited-liability companies that Mortgages Ltd. managed.

14           267. When Moya failed to prepare the contemplated Radical Bunny private-  
15 offering memorandum, Kant stepped forward to personally prepare the POM at a charge  
16 of \$20,000. Moya gave Kant permission to work directly with Hirsch in preparing the  
17 POM. Moya knew that Kant intended to list Quarles as counsel for Radical Bunny in the  
18 POM, noting that Kant wanted Quarles “on the book,” as Moya called the POM. Moya  
19 agreed that Quarles’ name could be used in the POM. Quarles was later listed as counsel  
20 in the draft POMs for Radical Bunny that were circulated among Greenberg, Quarles, and  
21 senior management for Mortgages Ltd. and Radical Bunny.

22           268. As explained above (¶¶ 167-71), Kant prepared drafts of a Radical Bunny  
23 POM in September and October 2007 that were circulated to Denning and Brown and  
24 from them to Moya and Bornhoft. A third draft was prepared in early November 2007.  
25 All of these drafts listed Quarles & Brady as counsel.

26           269. When Quarles received the draft private-offering memorandum from Kant,

1 Bornhoft asked Moya to review it over the following week. In an e-mail to Moya on  
2 November 28, 2007, Bornhoft noted that Radical Bunny preferred the draft to be  
3 reviewed by Moya rather than Hoffmann (who had told Hirsch to stop the illegal  
4 securities sales). Bornhoft acknowledged that “[y]ou and I are clearly the ‘Chosen Ones’  
5 for this client at this point in time.” Bornhoft and Moya were, in fact, chosen by Radical  
6 Bunny because they were willing to assist Radical Bunny in its ongoing illegal securities  
7 sales.

8 270. In response to Bornhoft’s e-mail, Moya agreed to review the draft POM  
9 even though he was “not current with respect to POM’s.” Moya also suggested that they  
10 turn to Kant to review securities-compliance issues associated with the draft private-  
11 offering memorandum even though “that won’t get Q&B [Quarles] off the hook if  
12 something falls between the cracks.”

13 271. Moya reviewed Kant’s draft of the private-offering memorandum and  
14 concluded that it was “quite good.” *See supra* ¶ 171. Moya particularly liked the risk  
15 factors disclosed in the draft POM, noting that they “were enough to scare off anyone”  
16 and “[t]hat is a good thing because I think many of the items constitute real risks.” But  
17 the draft POM and risk factors that satisfied Moya disclosed the risks stemming from  
18 neither Radical Bunny’s past nor ongoing securities registration, licensing, and disclosure  
19 (antifraud) violations. In that regard, the POM was no better than the inadequate  
20 disclosures Quarles had already given Radical Bunny for use in the interim.

21 272. At the November 2007 meeting of Radical Bunny investors, Hirsch once  
22 again reassured the investors that Quarles’ work on the private-offering memorandum  
23 was continuing. But while assuring investors that Quarles was looking out for their  
24 interests, Hirsch failed once again to tell them about Radical Bunny’s securities  
25 violations or that their investments were not secured by Mortgages Ltd.’s assets, as they  
26 had been led to believe.

1           273. As alleged above, Quarles advised Radical Bunny on an alternative strategy  
2 to continue sales to non-accredited investors. For example, in November 2007 Radical  
3 Bunny asked Quarles to explore the possibility of selling investments styled as fixed  
4 annuities through an insurance affiliate. According to notes prepared by Robert  
5 Bornhoft, Radical Bunny wanted to find a “safe haven for non-accredited” but “would  
6 still use [the investment] funds to invest in Mtgs. Ltd. products.” The Quarles attorney  
7 recognized that the proposed new strategy would raise “securities issues” and questioned  
8 “could this be viewed as attempt to circumvent securities law?”

9           274. In December 2007, Bornhoft learned that Hirsch wanted the option to  
10 continue funding Mortgages Ltd. under the same approach used in the past. Bornhoft  
11 therefore suggested to Hirsch that he open direct negotiations with Mortgages Ltd. on  
12 deal points that were acceptable to Radical Bunny. After that, the lawyers at Greenberg  
13 (Kant) and Quarles (Moya and Bornhoft) made no further efforts to address Radical  
14 Bunny’s past or ongoing securities violations.

15           275. With Quarles’ consent, Radical Bunny again told its investors at the May  
16 2008 meetings that Quarles’ work on the private-offering memorandum was continuing.

17           276. Thus, throughout 2007 and the first half of 2008, Quarles continued to  
18 assist Radical Bunny in its illegal sales of securities by working on a private-offering  
19 memorandum, by preparing interim disclosure documents, by assisting Hirsch in  
20 connection with the investor meetings, by advising Radical Bunny on alternative  
21 investment structures, and by lending Quarles’ name to Radical Bunny’s sales efforts.  
22 *See also supra* ¶ 196 (describing Quarles’ assistance). By doing so, Quarles not only  
23 provided substantial assistance and a façade of legitimacy to the ongoing fraudulent  
24 scheme, it also substantially induced and participated in the illegal securities sales.

25

26





1 securities interests *is either non-existent or defective in numerous respects.*” (Emphasis  
2 added). Bornhoft proposed the blanket security agreement as “an interim approach to  
3 dealing with the issue.” Bornhoft emphasized that the documentation needed to be “put  
4 in place immediately” and that Radical Bunny had “been absolutely clear with me that  
5 this is the arrangement your client agreed to.” (Emphasis in original).

6 282. Denning reacted emphatically and negatively to Bornhoft’s proposed  
7 security agreement. Denning learned about Bornhoft’s proposal when Kant sent him an  
8 e-mail forwarding the security agreement with the note that “[y]ou will not like this.”  
9 Denning replied that there was “[n]ot a snowball’s chance in you know where” that  
10 Mortgages Ltd. would grant the security interest belatedly sought by Radical Bunny.  
11 Denning knew that Mortgages Ltd.’s insolvency and lack of liquidity prevented it from  
12 paying Radical Bunny’s notes if they were called. He and Kant agreed that they would  
13 not create a situation where Radical Bunny could call the notes at maturity and use a  
14 security agreement to foreclose on Mortgages Ltd.’s assets.

15 283. During the ensuing months, Bornhoft continued to assist Radical Bunny in  
16 its efforts to find some retroactive way to secure the notes payable from Mortgages Ltd.  
17 to Radical Bunny. Bornhoft sent e-mails to Kant. When these were ignored, Bornhoft  
18 wrote a letter to Kant dated June 15, 2007. The letter complained that Radical Bunny “is  
19 becoming increasingly concerned by the lack of cooperation by your client in providing  
20 meaningful collateral security for the loans from our client to your client that are  
21 currently outstanding.” Bornhoft concluded the letter saying that, if Mortgages Ltd. did  
22 not sign the security agreement that Bornhoft had prepared or provide specific comments,  
23 Radical Bunny would “have no choice but to conclude that your client is unwilling to  
24 fulfill its obligations with respect to the outstanding loans, and our client will proceed  
25 accordingly.” After reading this, Kant e-mailed Denning that, “These people are getting  
26 annoying.”

1           284. Bornhoft and Radical Bunny had every reason to be concerned. As  
2 Bornhoft knew,

- 3           • Radical Bunny had falsely represented to its investors that the  
4 Mortgages Ltd. notes were secured;
- 5           • Hirsch had told Quarles that he would not admit to securities  
6 violations; and
- 7           • Radical Bunny was continuing to sell securities to investors under  
8 the false pretense that the investments were secured.

8           285. In August 2007, the issue came to a head when Kant sent Moya and  
9 Bornhoft the draft Radical Bunny POM that he had agreed to prepare for \$20,000. The  
10 organizational structure described in the POM did not provide for a security agreement  
11 that would collateralize Radical Bunny's outstanding notes from Mortgages Ltd. Once  
12 again, Hirsch and Bornhoft insisted that a perfected security agreement be provided.  
13 Kant and Denning were equally adamant that Mortgages Ltd. would not sign a security  
14 agreement.

15           286. Finally, on September 8, 2007, Kant bluntly notified Moya in a terse e-mail  
16 that "ML will not put up additional collateral."<sup>14</sup> Kant also told Moya that Mortgages  
17 Ltd. was not even obligated to pay its notes when they matured. Instead, the notes gave  
18 Mortgages Ltd. discretion to pay maturing notes by assigning deeds of trust. In Kant's  
19 words, "ML does not even have to pay in cash and your client will still be operating in a  
20 questionable manner."

21           287. Moya was surprised to learn that Mortgages Ltd. was not obligated to pay  
22 in cash. He asked Kant to tell him "why ML believes it is entitled to pay in kind instead  
23 of cash." Of course, as alleged above, Mortgages Ltd. was entitled to do just that under  
24 the terms of its notes to Radical Bunny (which apparently Moya had not even bothered to  
25 read). This was another material fact that Kant (and now Moya) knew had not been  
26

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<sup>14</sup> Kant was overstating things because no collateral of any kind existed.

1 disclosed to Radical Bunny's investors.

2 288. When Moya read the terms of the notes, he admitted that "I now agree with  
3 Kant." Moya also realized that Radical Bunny's failure to disclose this information to its  
4 investors was yet another material non-disclosure. Moya concluded that Mortgages  
5 Ltd.'s option to assign deeds of trust rather than paying off its notes did not "jive with  
6 what the client may have told existing investors with respect to their investments. I  
7 suspect no one thought they were buying into a note that could be paid off in kind."

8 289. Thus, not only had Quarles assisted Radical Bunny in continuing its illegal  
9 securities sales for many months under the false representation that the Mortgages Ltd.  
10 notes were secured; it had also recklessly disregarded that Radical Bunny's investors  
11 were being misled into believing they had the right to repayment at maturity that did  
12 exist.

13 290. Bornhoft's response was to try to wash his hands of the matter by telling  
14 Hirsch to negotiate with Mortgages Ltd. directly. Meanwhile, Radical Bunny continued,

- 15 • Selling unregistered securities in violation of the securities laws;
- 16 • Falsely representing to investors that their investments were secured;
- 17 • Falsely representing that Mortgages Ltd. had an obligation to pay the  
18 notes in cash; and
- 19 • Funding investor redemptions with money from new investors.

20 291. During the eight months in 2007 that Bornhoft allowed to pass without  
21 curing the misrepresentation that collateral existed, Radical Bunny raised more than  
22 \$22.9 million from new sales based on the false and misleading offering documents. The  
23 money from these new sales, as both Quarles and Greenberg knew, was loaned to  
24 Mortgages Ltd.

25 **3. Quarles withdraws after Coles' death.**

26 292. Coles died on June 2, 2008. The very next day, Bornhoft spoke with Hirsch

1 by telephone. Hirsch told Bornhoft that he expected a “run on the bank” as investors  
2 sought to redeem and that the Radical Bunny loans to Mortgages Ltd. now totaled almost  
3 \$200 million.

4 293. On June 6, Bornhoft discussed the matter with another partner at Quarles,  
5 who “review[ed] the file of investor materials from Radical Bunny” and who drafted and  
6 circulated a “potential investor script.”

7 294. On June 9, 2008, Quarles attorneys Bornhoft and Hoffmann spoke with  
8 Hirsch, Shah, and the Walders. During this call, Hoffmann and Hirsch both  
9 acknowledged that Radical Bunny had continued to sell securities on behalf of Mortgages  
10 Ltd. since the time Quarles began representing Radical Bunny more than a year earlier.

11 295. The next day, on June 10, 2008, Bornhoft sent a letter to Radical Bunny  
12 terminating Quarles’ representation. Bornhoft observed that in the wake of Mortgages  
13 Ltd.’s impending financial collapse Radical Bunny would be unable to make payments  
14 due to its investors. As a result, Bornhoft concluded that Radical Bunny would inevitably  
15 be sued by investors over the securities-law violations, non-disclosures, and licensing  
16 violations that Quarles itself had known about, participated in, and assisted for more than  
17 a year:

18 We are writing to confirm that our representation of your company  
19 has ended. . . . [I]t is almost certain that Mortgages Ltd. will not be  
20 able to pay its note obligations to Radical Bunny in accordance with  
21 their terms moving forward and this will prevent Radical Bunny  
22 from being able to service its own accounts. The inevitable claims  
23 which will follow will address the previous advice Quarles & Brady  
provided to Radical Bunny. This advice expressly dealt with  
procedures necessary to comply with securities laws going forward,  
correcting information and documentation previously provided to  
Radical Bunny’s customers, addressing its collateral position and  
addressing various licensing issues and banking regulations.

24 296. Quarles’ after-the-fact decision to discontinue representation of Radical  
25 Bunny came far too late for the investor Class members who had continued to invest  
26 funds and hold their Radical Bunny investments while Quarles actively assisted Radical

1 Bunny, knowingly participated in the ongoing fraudulent scheme, and helped induce  
2 illegal securities sales over the prior 13 months.

3 297. Ironically, one of the after-the-fact justifications offered by Quarles for its  
4 disassociation with Radical Bunny was the possibility that the firm represented some of  
5 the 900 Radical Bunny investors and therefore might have a conflict of interest. Quarles  
6 apparently did not bother to investigate these potential conflicts while it was accepting  
7 fees and building a relationship with Radical Bunny.

8 **C. Mayer Hoffman & McCann's Role**

9 **1. Mayer Hoffman's audits were essential to Mortgages Ltd.'s**  
10 **ability to raise money from investors.**

11 298. For nearly a decade (beginning in 1998-99), Mayer Hoffman served as  
12 Mortgages Ltd.'s outside auditor.

13 299. Because of its long history with Mortgages Ltd., Mayer Hoffman was  
14 intimately familiar with the Company's business model, its employees, its products, and  
15 its exposure to real estate and mortgage-backed assets.

16 300. Mayer Hoffman's work included auditing Mortgages Ltd.'s financial  
17 statements for fiscal years ending in 2005, 2006, and 2007.

18 301. Mayer Hoffman knew its audit reports would be used and relied upon by  
19 prospective and existing investors (or their financial advisors) to evaluate the purchase  
20 and holding of Mortgages Ltd.'s securities. Thus, Mayer Hoffman acknowledged in risk-  
21 assessment documents produced for the SEC that Mortgages Ltd.'s audited "financial  
22 statements are used to secure additional funding and to provide evidence of financial  
23 stability to investors interested in purchasing mortgage backed securities." Mayer  
24 Hoffman also noted in these documents that (a) investors were Mortgages Ltd.'s primary  
25 source of financing and (b) the investments included "short term loans from Radical  
26 Bunny, LLC and sales of participation (mortgage backed securities to investor pools)."

1           302. For fiscal years 2005, 2006, and 2007, Mayer Hoffman provided clean  
2 audit reports, which represented that—

- 3           • Mayer Hoffman had conducted its audits in accordance with  
4           Generally Accepted Auditing Standards (GAAS); and
- 5           • Mortgages Ltd.'s financial statements fairly presented, in all material  
6           respects, its financial position for fiscal years 2005, 2006, and 2007,  
7           in conformity with General Accepted Accounting Procedures  
8           (GAAP).

9           303. These clean audit reports were essential to Mortgages Ltd.'s ability to  
10 continue raising money through its debt-offerings to Plaintiffs and other investors in the  
11 proposed Classes.

12           304. In conducting its audits, Mayer Hoffman had unique access to the  
13 underlying information used to prepare Mortgages Ltd.'s financial statements. This  
14 information was not available to the public. Mayer Hoffman knew that a central purpose  
15 of its audits was to have the firm act as a reputational intermediary who would use its  
16 unique access to inside information to provide independent assurances of financial  
17 stability to Mortgages Ltd.'s investors.

18           305. Mayer Hoffman, CBIZ, Inc., and CBIZ MHM, LLC jointly promoted  
19 themselves as one of the foremost accounting and professional-service firms in the  
20 nation, with special experience in real estate. One of CBIZ's websites touts its Valuation  
21 Group's expertise in all types of real-estate valuations. In turn, Mayer Hoffman's  
22 website promotes its attest services with statements like the following: "Mayer Hoffman  
23 McCann, P.C.'s expertise may be supplemented with resources available through our  
24 close association with CBIZ, Inc., . . . a national multidisciplinary services company  
25 [that] is one of the nation's largest providers of professional business services."

26           306. Mayer Hoffman was well aware of the particular audit risks<sup>15</sup> at Mortgages

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<sup>15</sup> *Audit risk* is the risk that the auditor will not detect that the financial statements are materially misstated. Auditors successfully reduce audit risk by designing and

1 Ltd. that were associated with the Company's real-estate-related assets. During its field  
2 work and planning for the 2005, 2006, and 2007 audits, Mayer Hoffman reviewed  
3 Mortgages Ltd.'s internal controls, paying specific attention to real-estate asset  
4 valuations, which Mayer Hoffman recognized involved especially sensitive valuation  
5 estimates. In fact, in connection with the 2007 audit, the senior on the Mayer Hoffman  
6 auditor team sent an e-mail to Defendant Olson explaining that "the name of the game  
7 this year is impairment and collateral testing."

8 307. Mayer Hoffman recognized or should have recognized the risk of  
9 nonpayment (especially of high-interest bridge loans like those in which Mortgages Ltd.  
10 specialized) as well as the risk of a downturn in the economy and the dangers of an  
11 overconcentrated investment in a small pool of large loans.

12 308. Mayer Hoffman also recognized or should have recognized the audit risk  
13 created by Mortgages Ltd.'s exposure to even a minor downturn in Arizona's commercial  
14 real-estate market.

15 309. Prudent mortgage lending requires reserves that reflect losses inherent in a  
16 loan portfolio, but higher reserves mean lower net income and a decrease in total assets.  
17 A basic principle of financial accounting standards requires recording real-estate assets at  
18 fair value and recording loan impairments. As explained below (¶¶ 369-75), Mortgages  
19 Ltd. overvalued its real-estate assets and failed to properly record loan impairments or  
20 reserves.

21 310. Audits are designed to obtain an opinion on whether a company's financial  
22 statements fairly present, in all material respects, the financial position of the company in  
23 conformity with GAAP. To accomplish this, audits must be conducted in accordance  
24 with GAAS, which are codified in Statements of Auditing Standards (SAS) that are  
25 referred to with an AU number.

26 performing proper audit procedures. AU 312.12.



1           311. As acknowledged in Mayer Hoffman's audit opinions, and as set forth in  
2 AU 110.02, the firm had the affirmative duty under GAAS to plan and perform its audits  
3 to obtain reasonable assurance that the Company's financial statements were free of  
4 material misstatement, whether caused by error or fraud.

5           312. To obtain this reasonable assurance, the independent auditor has to perform  
6 the procedures called for by GAAS. Then, after performing these procedures, the auditor  
7 must decide if anything came to the auditor's attention that would lead the auditor to  
8 believe that the financial statements are not fairly presented in accordance with GAAP.  
9 AU 150.02 (Standards of Fieldwork). Thus, the audit process *requires professional*  
10 *skepticism* to properly test management's representations. In this way, the auditor has a  
11 reasonable basis on which to form an opinion regarding the financial statements.  
12 AU 333.02. The audit opinion is valuable precisely because the auditor is supposedly  
13 conducting an *independent* and *skeptical* examination of the information provided by  
14 management.

15           313. Under GAAS, the auditor must consider both audit risk (see *supra* note 15)  
16 and materiality in (a) planning the audit and designing audit procedures, and (b) in  
17 evaluating the results of the audit in relation to the financial statements as a whole.  
18 AU 312.11. The auditor must plan the audit to obtain reasonable assurance of detecting  
19 material misstatements that the auditor believes could be large enough, individually or in  
20 the aggregate, to be quantitatively material to the financial statements. AU 312.18.

21           314. Mayer Hoffman failed to adhere to these basic accounting principles. As a  
22 result, its audit reports misrepresented to investors the true financial condition of  
23 Mortgages Ltd. and misrepresented that Mayer Hoffman had conducted its audits in  
24 compliance with GAAS.

25           315. In performing its audit work for Mortgages Ltd., Mayer Hoffman agreed  
26 and had a duty to perform its work in conformity with GAAS. GAAS establishes ten

1 Professional Standards of Care:

2 **General Standards**

- 3 1. The audit must be performed by a person or persons having adequate  
4 technical training and proficiency as an auditor.
- 5 2. In all matters relating to the assignment, an independence in mental  
6 attitude is to be maintained by the auditors.
- 7 3. Due professional care is to be exercised in the planning and  
8 performance of the audit and the preparation of the report.

9 **Standards of Field Work**

- 10 4. The work is to be adequately planned and assistants, if any, are to be  
11 properly supervised.
- 12 5. A sufficient understanding of internal controls is to be obtained to  
13 plan the audit and to determine the nature, timing, and extent of tests to be  
14 performed.
- 15 6. Sufficient competent evidential matter is to be obtained through  
16 inspection, observation, inquiries, and confirmations to afford a reasonable  
17 basis for an opinion regarding the financial statements under audit.

18 **Standards of Reporting**

- 19 7. The report shall state whether the financial statements are presented  
20 in accordance with Generally Accepted Accounting Principles.
- 21 8. The report shall identify those circumstances in which such  
22 principles have not been consistently observed in the current period in  
23 relation to the preceding period.
- 24 9. Informative disclosures in the financial statements are to be regarded  
25 as reasonably adequate unless otherwise stated in the report.
- 26 10. The report shall either contain 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 therefor 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.

316. From its annual audit work, Mayer Hoffman knew or negligently  
disregarded—

- The true financial condition and exposure of Mortgages Ltd.,

- 1                   •     The value of Mortgages Ltd.'s real-estate assets; and  
2                   •     Mortgages Ltd.'s deteriorating financial condition,  
3 which contradicted the unqualified audit reports on Mortgages Ltd.'s financial  
4 statements.

5           317. During its audit work, Mayer Hoffman identified material weaknesses in  
6 Mortgages Ltd.'s internal-control structure. These weaknesses are discussed below and  
7 were identified in internal-control reports issued by Mayer Hoffman to Mortgages Ltd.'s  
8 board of directors in connection with the 2006 and 2007 audits. Despite these material  
9 weaknesses, Mayer Hoffman issued clean, unqualified audits for Mortgages Ltd.'s  
10 financial statements.

11           318. Mayer Hoffman violated GAAS General Standard No. 3, which requires  
12 the auditor to exercise due professional care in the performance of the audit and  
13 preparation of the audit report.

14           319. Mayer Hoffman also violated GAAS Reporting Standard No. 1, which  
15 requires the audit report to state whether the financial statements are presented in  
16 accordance with GAAP. Mayer Hoffman's audit opinion falsely represented that  
17 Mortgages Ltd.'s financial statements complied with GAAP. For example, Mayer  
18 Hoffman negligently,

- 19                   •     Concluded that GAAP (i.e., FIN 46)<sup>16</sup> allowed Mortgages Ltd. to  
20 present its financial statements without consolidating the limited-  
21 liability companies through which Mortgages Ltd. raised money.  
22                   •     Certified Mortgages Ltd.'s financial statements as GAAP compliant  
23 even though, contrary to FAS 57,<sup>17</sup> Radical Bunny was not identified  
24 as a related party and all material transactions between Radical  
25 Bunny and Mortgages Ltd. were not disclosed.

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25           <sup>16</sup> FASB Accounting Standards Codification Subtopic 810-10-15, Consolidation-  
26 Entities (Codifying FASB Interpretation No. 46).

<sup>17</sup> FASB Accounting Standards Codifications Subtopic 850-10, Related Party  
Disclosures (codifying Statement of Financial Accounting Standards No. 57).

- 1 • Represented that Mortgages Ltd.'s financial statements were GAAP  
2 compliant even though Mortgages Ltd. did not report its real-estate  
3 assets at fair value as required by FAS 157<sup>18</sup> and failed to disclose  
4 the fair-value methods used in valuation as required by FAS 107.<sup>19</sup>

5 320. These misstatements in Mortgages Ltd.'s financial statements were material  
6 and misrepresented Mortgages Ltd.'s compliance with GAAP. In making these  
7 misstatements, Mayer Hoffman breached its professional responsibilities and acted in  
8 violation of GAAS in its audits of the 2005, 2006, and 2007 financial statements of  
9 Mortgages Ltd. The GAAS violations are described more particularly in the following  
10 paragraphs.

11 321. Mayer Hoffman violated GAAS Field Standard No. 1, and the standards set  
12 forth in AU sections 311, 314, 318, and others, by failing to adequately plan its audit and  
13 properly supervise the work of assistants to establish and carry out procedures reasonably  
14 designed to search for and detect the existence of errors and irregularities that would have  
15 a material effect upon the financial statements.

16 322. Mayer Hoffman violated AU section 316, which requires the auditor to plan  
17 and perform its examination of the financial statements with professional skepticism.  
18 Section 316 begins with the statement that: "the auditor has a responsibility to plan and  
19 perform the audit to obtain reasonable assurance about whether the financial statements  
20 are free of material misstatement, whether caused by error or fraud." AU 316.01.  
21 Numerous audit red flags and risk factors existed that should have alerted Mayer

22 . . .

23 . . .

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24 <sup>18</sup> FASB Accounting Standards Codifications Subtopic 820-10, Fair Value  
25 Measurements and Disclosures (codifying Statement of Financial Accounting Standards  
26 No. 157).

<sup>19</sup> FASB Accounting Standards Codifications Subtopic 820-10-50, Fair Value  
Measurements and Disclosures (codifying Statement of Financial Accounting Standards  
No. 107).

1 Hoffman to the potential for misstatements. These red flags and risk factors include the  
2 material weaknesses identified in Mayer Hoffman's internal-control reports. They also  
3 include:

- 4 • The resignation of three members of senior management  
5 (Defendants Denning, Brown, and Newman) during the months  
6 leading up to the 2007 audit report.
- 7 • The atypical lending terms between Mortgages Ltd. and its largest  
8 investor-lender, i.e., Radical Bunny. *See infra* ¶ 352.
- 9 • Adverse key financial ratios. *See infra* ¶¶ 357-60 & n. 34.
- 10 • The Company's increasing dependence on cash flow from  
11 Mortgages Ltd. and Radical Bunny investors. *See* Table 3 in the  
12 following paragraph, depicting the rise in borrowing from Radical  
13 Bunny and Mortgages Ltd. investors.
- 14 • Working capital deficiencies.
- 15 • The cessation of loan originations in 2007. During the 2007 audit,  
16 Defendant Olson told the Mayer Hoffman auditors that loan  
17 originations had ceased.
- 18 • Efforts by Mortgages Ltd. in 2007 to expand its financing by having  
19 outside broker-dealers and investment advisors sell the Company's  
20 securities.
- 21 • Increased loan extensions and default workouts that increased the  
22 time required for loan repayment.
- 23 • Termination of Mortgages Ltd.'s profit-sharing plan. According to  
24 Defendant Olson's SEC testimony, the Mayer Hoffman auditors  
25 knew, during the 2007 audit, that the profit-sharing plan had been  
26 terminated.
- A weakening economy that signaled greater mortgage impairments  
and reductions in asset carrying values.
- By the end of 2007, Mortgages Ltd. did not have the cash flow to  
meet redemption requests that had historically been honored.  
According to Defendant Olson's SEC testimony, the Mayer  
Hoffman auditors were aware of this.

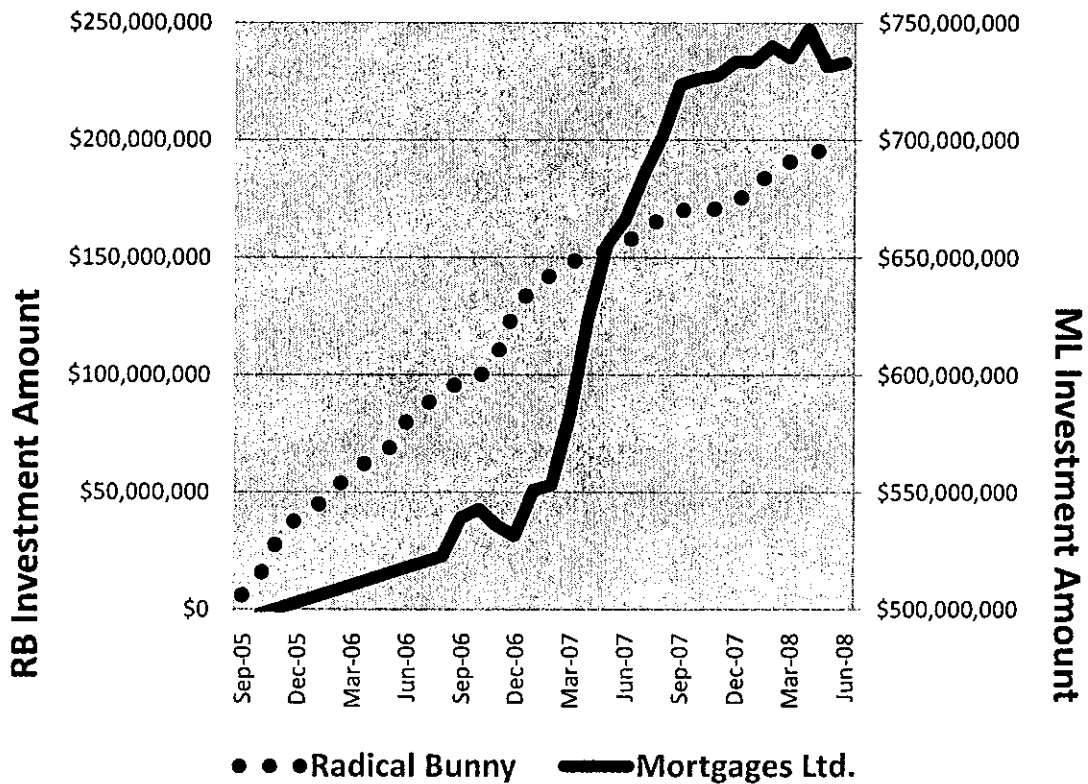
323. In his SEC testimony, Charles McLane, the engagement partner for the  
2006 and 2007 audits, acknowledged that information indicating that any of the following  
had occurred would be an important fact for an auditor to consider:

- 1 • That Mortgages Ltd. had stopped making new loans.
- 2 • That Mortgages Ltd. had ended its employee profit-sharing payments.
- 3
- 4 • That Mortgages Ltd. had stopped honoring investor redemption requests.

5 According to Defendant Olson, Mayer Hoffman was aware, during the 2007 audit, of  
 6 each of these adverse facts.

7 324. The graph in Table 3 describes the increase in investor borrowing during  
 8 the Class period, i.e., from September 2005 through June 2008. As shown by the graph,  
 9 debt due Radical Bunny increased from \$14.8 million at October 31, 2005 to  
 10 approximately \$197 million at June 30, 2008. Debt due Mortgages Ltd. investors  
 11 increased from about \$498 million at October 31, 2005 to approximately \$733 million at  
 12 June 30, 2008.

13 **Table 3 — Increase in Debt Due Investors**



26

1           325. Because of this increase in debt, Mortgages Ltd.'s interest expense  
2 quadrupled, increasing from \$13 million at October 31, 2005 to \$60 million at December  
3 31, 2007. As a percentage of revenue, interest expense during the same period increased  
4 from 32% of total revenue to 57% of total revenue.<sup>20</sup>

5           326. Despite the red flags described in the three preceding paragraphs, Mayer  
6 Hoffman failed to expand its audit procedures and perform effective audit testing to  
7 obtain more reliable, persuasive audit evidence. AU section 316.27, which discusses the  
8 need to exercise professional skepticism in response to the risk of material misstatement,  
9 requires: (a) increased sensitivity in the selection of the nature and extent of  
10 documentation to be examined in support of material transactions, and (b) increased  
11 recognition of the need to corroborate management explanations or representations  
12 concerning material matters. As AU section 316.52 states, "[t]he nature of audit  
13 procedures may need to be changed to obtain evidence that is more reliable or to obtain  
14 additional corroborative information. For example, more evidential matter may be  
15 needed from independent sources outside the entity." In this regard, Mayer Hoffman  
16 failed to (a) obtain adequate confirmations or otherwise communicate directly with  
17 Mortgages Ltd.'s borrowers and the Company's primary lender (i.e., Radical Bunny) and  
18 (b) fully understand the relationship between Radical Bunny and Mortgages Ltd., despite  
19 knowledge of risk factors and audit red flags that required auditor follow up.

20           327. In summary, and as more fully explained below, by giving unqualified  
21 audit opinions for the Mortgages Ltd.'s financial statements for fiscal years 2005, 2006,  
22 and 2007, Mayer Hoffman represented that its audits of Mortgages Ltd.'s books and  
23 records were done in accordance with GAAP and GAAS. They were not. Thus, Mayer  
24 Hoffman's audit reports were materially misleading and falsely reported Mortgages  
25

26           <sup>20</sup> These calculations assume that the financial statements were properly  
consolidated as required by FIN 46.

1 Ltd.'s financial condition to the Company's investors.

2                   **2. Mayer Hoffman knew that Mortgages Ltd.'s CFO lacked the**  
3                   **skills to prepare GAAP-compliant financial statements.**

4           328. Defendant Olson was Mayer Hoffman's primary management contact in  
5 connection with the 2005, 2006, and 2007 audits.

6           329. Olson lacked the skills to competently prepare the financial statements that  
7 were the basis for Mayer Hoffman's audits.

8           330. Mayer Hoffman was aware of Olson's shortcomings. Olson's lack of  
9 familiarity with GAAP and audit standards was explained in a March 2007 memo  
10 prepared after Mayer Hoffman's 2006 audit. Mayer Hoffman wrote:

- 11                   • "The initial draft of the consolidated financial statements provided  
12 by management [Olson] did not include all required disclosures  
13 under GAAP. In addition, certain transactions were not properly  
14 classified or presented in the consolidated financials."  
15                   • "Company personnel [Olson and his assistants] do not have the  
16 appropriate tools, such as, disclosure checklists, AICPA accounting  
17 and audit guides and other authoritative literature necessary to  
18 prepare the Company's annual consolidated financial statements  
including related footnote disclosures in accordance with GAAP."  
19                   • "It is strongly recommended that those individuals [Olson and his  
20 assistants] responsible for the maintenance of the Company's  
21 accounting records seek out opportunities to enhance their  
22 understanding of generally accepted accounting principles (GAAP)."

23           331. As a result of the quoted findings, Mayer Hoffman knew that Olson's lack  
24 of understanding regarding GAAP and audit requirements was a material weakness in the  
25 reliability of Mortgages Ltd.'s accounting system.

26           332. Under AU section 318, this material weakness required higher scrutiny and  
more skepticism in auditing the financial statements that Olson prepared.

          333. Deficiencies in Olson's work required a restatement of the audited 2005  
financials. These deficiencies also required Mayer Hoffman to actively assist Olson in  
preparing the 2006 financial statements that Mayer Hoffman audited. In other words, for



1 the 2006 audit, Mayer Hoffman was actively involved in both preparing and auditing  
2 what were supposed to be management's financials.

3 **3. Mortgages Ltd.'s financial statements should have been**  
4 **consolidated to include the limited-liability companies that**  
5 **Mortgages Ltd. managed.**

6 334. Mortgages Ltd. securitized its loan participations and sold the participation  
7 interests through limited-liability companies (LLCs). Mortgages Ltd. was the manager of  
8 these limited-liability companies.

9 335. Investors in these LLCs were passive investors who depended upon  
10 Mortgages Ltd. for the managerial experience and know-how to manage the LLCs.

11 336. Investors did not have the experience, desire, or know-how to manage a  
12 complex company like Mortgages Ltd.

13 337. Under the operating agreements that governed the LLCs, Mortgages Ltd.  
14 retained exclusive discretion over all aspects of the loans in which the LLCs invested.  
15 Thus, Mortgages Ltd. had exclusive authority on matters such as loan quality, loan terms,  
16 loan rewrites, loan modifications, and decisions on declaring defaults. Investors in the  
17 LLCs had no right to participate in these decisions or to remove Mortgages Ltd. because  
18 of disagreements about its business judgment in making management decisions.

19 338. Under the operating agreements, Mortgages Ltd. could be removed only for  
20 willful misconduct or fraud.<sup>21</sup> A supermajority vote (75%) was required for removal.  
21 Investor-members were given no right to remove Mortgages Ltd. because of  
22 disagreements about nonfraudulent managerial decisions.

23 339. Through FIN 46,<sup>22</sup> GAAP requires consolidation when equity holders like

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24 <sup>21</sup> Removal for "willful misconduct or fraud" became the standard in June 2006  
25 when Greenberg revised the POM and operating agreement for the MP 12 offering.  
26 Before that, the Mortgages Ltd. could be removed only for a "materially negligent act or  
omission to act."

<sup>22</sup> Cited *supra* note 16.

1 Mortgages Ltd.'s investors lack the ability through voting or similar rights to "make  
2 decisions about an entity's activities that have a significant effect on the success of the  
3 entity."

4 340. Because of the exclusive managerial control and discretion that Mortgages  
5 Ltd. possessed, Mortgages Ltd.'s investors had no control over the business decisions that  
6 determined the success of the limited-liability companies. Thus, FIN 46 required that the  
7 2005, 2006, and 2007 financial statements be presented as consolidated statements that  
8 included the limited-liability companies.

9 341. Because of the terms of the operating agreements and the POMs, no  
10 reasonable auditor could have concluded that the investors in the limited-liability  
11 companies had the ability to control Mortgages Ltd.

12 342. Even so, Mayer Hoffman negligently represented to investors in its 2005,  
13 2006, and 2007 audit reports that Mortgages Ltd.'s financial statements complied with  
14 GAAP despite the fact that, contrary to FIN 46, the Mortgages Ltd.'s financial statements  
15 did not consolidate the limited-liability companies.

16 **4. Because the financial statements were not properly consolidated,**  
17 **they misrepresented Mortgages Ltd.'s financial condition.**

18 343. By failing to consolidate the limited-liability companies, the financial  
19 statements and Mayer Hoffman's audit reports misrepresented Mortgages Ltd.'s debt,  
20 leverage of assets and equity, interest expense, and lack of liquidity. For example, when  
21 consolidated, Mortgages Ltd.'s October 31, 2005 balance sheets show a debt-to-equity  
22 ratio of 248x rather than the 10.7x ratio shown on an unconsolidated basis.<sup>23</sup>

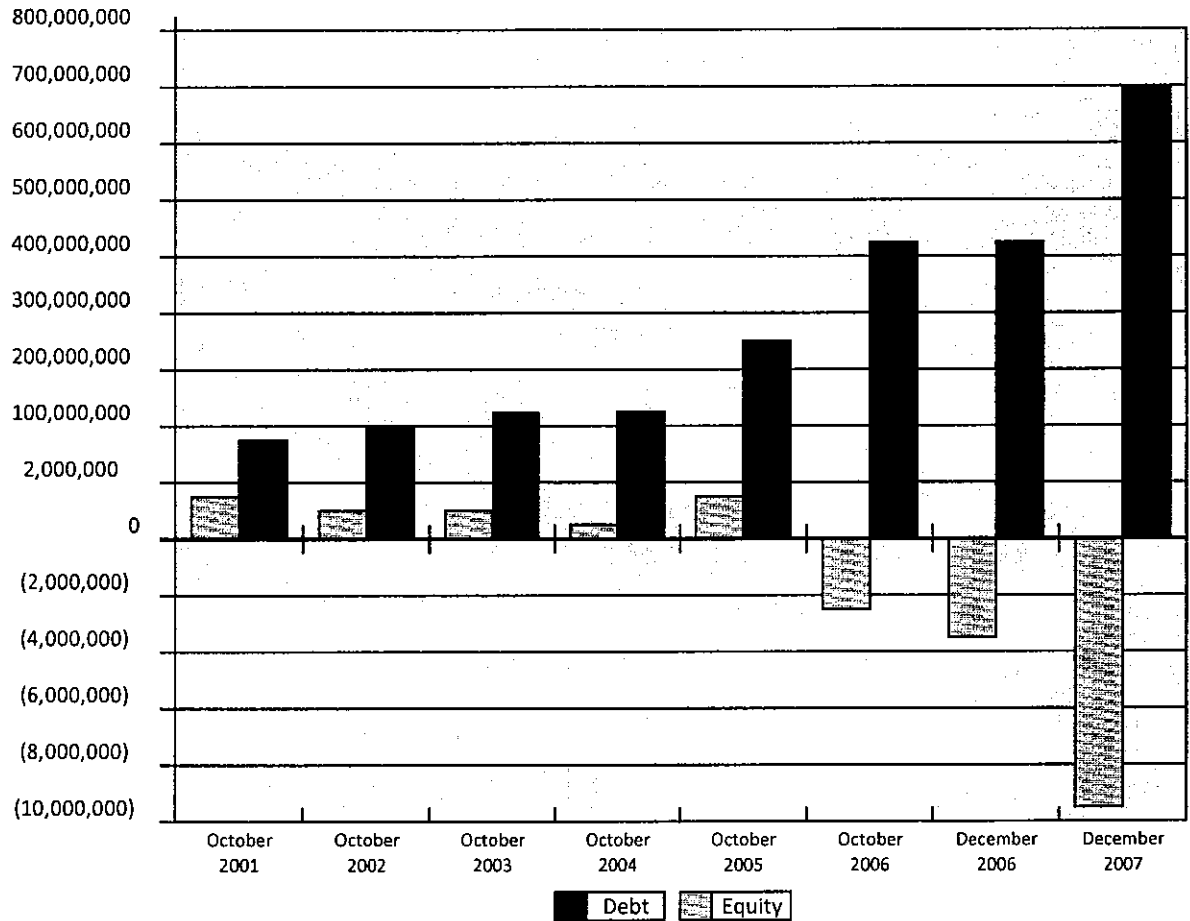
23 344. The adverse 2005 debt-to-equity ratio was part of an abrupt reversal of  
24 Mortgages Ltd.'s financial condition that began in 2005. The Company's spiral into

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25  
26 <sup>23</sup> Debt-to-equity is defined as total debt divided by total equity. A debt-to-equity  
ratio of 248x means that there is \$24,800 of debt to third parties on the books of  
Mortgages Ltd. for every \$100 of equity belonging to the owners.

1 negative equity and increasing debt levels was masked by the decision not to consolidate  
 2 the LLCs is shown by the following table:<sup>24</sup>

3 **Table 4 — Debt and Equity Balances by Year**



20 345. As red-flagged by these ratios, and as explained in Part IV(C)(6) below, if  
 21 the LLCs had been included as consolidated entities, Mortgages Ltd. would have been  
 22 insolvent—a fact that a reasonable auditor would have disclosed.

23 **5. The disclosures regarding notes payable to Radical Bunny were  
 24 materially incomplete and misleading.**

25 346. Although Mortgages Ltd. borrowed \$14,820,000 from Radical Bunny in the  
 26 last two months of the 2005 fiscal year, the Company's audited 2005 financial statements

<sup>24</sup> Numbers in the table are after consolidation.

1 do not include any disclosure regarding Mortgages Ltd.'s indebtedness to Radical Bunny.

2 347. The first disclosure regarding Radical Bunny appears in footnote 9 of the  
 3 2006 and restated 2005 financials. Without mentioning Radical Bunny by name, footnote  
 4 9 provides the following description of the notes payable to Radical Bunny:

| "Notes payable consist of:   | December 31,<br>2006 | October 31,<br>2006 | October 31,<br>2005 |
|--|----------------------|---------------------|---------------------|
| Notes payable to an investor, collateralized by the assets of the Company, payable in monthly installments of interest only at a rate of 13% annually, maturing in various months in 2007. Notes payable as of October 31, 2006 and 2005 had terms of 12 months or less. | \$128,839,758        | \$99,008,500        | \$14,820,000        |

14  
 15 The notes payable amounts above can be repaid through the assignment of participation interests in mortgages investments."

17 348. Footnote 11 of the 2007 audited financial statements contains a similar  
 18 description of Mortgages Ltd.'s notes payable to Radical Bunny. It reads:

19 The Company has \$172,609,758 of outstanding notes payable  
 20 with one lender as of December 31, 2007, of which  
 21 \$127,215,351 represents notes entered into during 2006 that  
 22 were renewed in 2007 and \$45,394,407 represents new notes  
 23 issued in 2007. The notes are collateralized by the assets of  
 24 the Company, payable in monthly installments of interest  
 25 only at 13% and maturing at various times during 2008. The  
 26 monthly interest installments approximated \$1,870,000 per  
 month during the year ended December 31, 2007. The lender  
 allows for repayment to be made through the assignment of  
 participation interests in mortgage investments held for  
 investment and sale.

1           349. Under GAAP (FAS 57),<sup>25</sup> Radical Bunny and Mortgages Ltd. were related  
2 parties. In that regard, Radical Bunny acted as an unregistered, captive-securities dealer,  
3 which sold Mortgages Ltd. loan participations to investors. *See supra* ¶¶ 75-76 and 142.  
4 Because of the financial ties between the two companies, Mortgages Ltd. was able to  
5 significantly influence Radical Bunny's management and Radical Bunny's operating and  
6 investment policies.

7           350. Contrary to FAS 57, the related-party disclosures in the footnotes to  
8 Mortgages Ltd.'s 2005, 2006, and 2007 financial statements did not identify Radical  
9 Bunny as a related party and did not make the disclosures required by FAS 57.

10           351. Because of the related party relationship, AU section 334 required that the  
11 transactions between Mortgages Ltd. and Radical Bunny be given greater auditor  
12 scrutiny. Similarly, FAS 57 required detailed related-party disclosures.

13           352. From examining Mortgages Ltd.'s notes to Radical Bunny and the payment  
14 history under them, Mayer Hoffman knew or should have known that the notes contained  
15 atypical terms that would not be accepted in an arms-length commercial transaction.

16 Examples of the atypical terms include the following:

- 17           • Notes from Mortgages Ltd. to Radical Bunny were never paid at  
18 maturity. The notes were always rolled into new notes with new  
maturities.
- 19           • Mortgages Ltd. was not required to repay the notes in cash. Instead,  
20 it could pay the notes by assigning loan participations.
- 21           • The notes were written to allow payment in loan participations even  
22 though Mortgages Ltd.'s financial statements showed that it did not  
have enough mortgage investments to pay Radical Bunny's notes if  
they were called.
- 23           • Mortgages Ltd. was given complete discretion to decide what loan  
24 participations were assigned.
- 25           • The notes paid an above-market, 13% rate of return.

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26           <sup>25</sup> Cited *supra* note 17.

1 353. Contrary to FAS 57, the representations in the footnotes quoted above were  
2 incomplete and misleading in the following ways:

- 3 • The notes were not collateralized by Mortgages Ltd. assets.
- 4 • By their terms, the notes did not provide for security.
- 5 • A security agreement between Radical Bunny and Mortgages Ltd.  
6 did not exist.
- 7 • A security interest in Mortgages Ltd.'s assets had not been perfected.
- 8 • Mortgages Ltd. did not hold enough mortgage investment interests  
9 to pay the Radical Bunny notes by assignments. At December 31,  
10 2006, Mortgages Ltd.'s indebtedness to Radical Bunny exceeded the  
11 mortgage investments that Mortgages Ltd. owned by \$49.2 million.  
12 At December 31, 2007, Mortgages Ltd.'s indebtedness to Radical  
13 Bunny exceeded the mortgage investments that Mortgages Ltd.  
14 owned by \$20.1 million.

15 **6. The financial statements required going-concern disclosures that  
16 were not made.**

17 354. AU section 341 (i.e., SAS 59)<sup>26</sup> requires an auditor to evaluate whether  
18 there is a substantial doubt about the entity's ability to continue as a going concern for a  
19 reasonable period of time. Conditions such as working-capital deficiencies, negative  
20 cash flows, and adverse financial ratios coupled with other indications of financial  
21 difficulties must be considered in the aggregate to decide if an opinion or disclosure on  
22 the entity's ability to continue as a going concern is needed.

23 355. By the fourth quarter of 2005, Mortgages Ltd. was cash-flow insolvent.<sup>27</sup>  
24 The Company at this point was dependent on loans funded by illegal money that Radical  
25 Bunny was raising through violations of Arizona and federal securities laws. To cover its  
26 operating expenses, Mortgages Ltd. borrowed \$38.9 million from Radical Bunny in the  
final four months of 2005.

---

25 <sup>26</sup> Codification of Accounting Standards and Procedures, Statement on Auditing  
Standards No. 59 (Am. Inst. of Certified Pub. Accountants 1988).

26 <sup>27</sup> *Cash-flow insolvent* means that a company is unable to generate enough cash  
flow from its own operations to support its daily expense of doing business.

1 356. By 2006, Mortgages Ltd. was balance-sheet insolvent.<sup>28</sup> With  
 2 consolidation, Mortgages Ltd. would have shown a negative net worth in 2006 and 2007,  
 3 as follows:

4 **Table 5 — Negative Net Worth By Year**

| Date              | Net Worth   |
|-------------------|-------------|
| October 31, 2006  | (2,480,888) |
| December 31, 2006 | (3,673,014) |
| December 31, 2007 | (9,435,653) |

5  
 6  
 7  
 8  
 9  
 10 357. Similarly, with consolidation, the October 31, 2005 audited balance sheet  
 11 shows negative working capital with a current ratio of 0.99x.<sup>29</sup> After consolidation, the  
 12 2005 debt-to-asset ratio<sup>30</sup> increases from 0.87x to 0.96x and the debt-to-equity ratio<sup>31</sup>  
 13 increases from 10.7x to 248x. On the income side, income coverage for 2005 decreased  
 14 from 7.9x to 1.6x,<sup>32</sup> and interest expense rose from 6% to 32% of total revenue.<sup>33</sup> Other  
 15 adverse financial ratios that the auditors should have considered in a going-concern  
 16

17  
 18 <sup>28</sup> *Balance-sheet insolvent* means a company has negative equity. Stated another  
 19 way, liabilities exceed assets so that the company's balance sheet has no positive value.

20 <sup>29</sup> The *current ratio* is defined as current assets divided by current liabilities. A  
 21 current ratio below 1.0 means there is negative working capital with current liabilities  
 22 exceeding current assets. In other words, there are not enough liquid assets available to  
 23 cover the payment of all current expenses due.

24 <sup>30</sup> The *debt-to-asset ratio* is defined as total debt divided by total assets. A debt-  
 25 to-asset ratio at or above 1.0 means that all assets of the company are debt financed.  
 26 Equity financing is non-existent and the company has zero positive value.

<sup>31</sup> See *supra* note 23 for definition.

<sup>32</sup> *Income coverage* is defined as net income before interest expense divided by  
 interest expense. As income coverage approaches 1.0, the company has less ability to  
 pay off interest expense each year. Income coverage below 1.0 signifies the company  
 does not have enough income to pay interest expense.

<sup>33</sup> *Interest Expense Percent* is defined as interest expense divided by total revenue.  
 As the percentage increases, more revenue is required to cover interest expense and  
 cannot be used for other operations of the company.

1 analysis are listed and defined in the footnote.<sup>34</sup> These adverse financial ratios required a  
2 going-concern qualification or disclosure. But no such qualification or disclosure was  
3 made in the original or restated 2005 audit reports that Mayer Hoffman knew would be  
4 used by investors and their financial advisors to evaluate Mortgages Ltd.'s financial  
5 condition.

6 358. For 2005, the asset-to-equity ratio after consolidation was 260x, an  
7 extremely leveraged position. For every \$100 of assets on the books of Mortgages Ltd.,  
8 only 39 cents was due to earnings. In other words, 99.6% of every dollar of assets on the  
9 Company's books was owned by third parties or was the result of borrowings.

10 359. Comparatively, Lehman Brothers, a highly leveraged company that filed  
11 the largest bankruptcy in U.S. history in September 2008, had asset-to-equity ratios in the  
12 months preceding its bankruptcy of 16.1x at 4Q07, 15.4x at 1Q08, and 12.0x at 2Q08.  
13 Lehman's excessive leverage was a major factor in its bankruptcy. Yet Lehman's  
14 leverage ratios were a fraction of Mortgages Ltd.'s leverage.

15 360. The volume of Mortgages Ltd.'s debt as a percentage of its assets, and the  
16 associated interest expense are shown in Table 6. As depicted by the graph in Table 6, by  
17 2005 Mortgages Ltd. had leveraged itself to the point that its debt essentially equaled or

18  
19 <sup>34</sup> Other adverse ratios that Mayer Hoffman disregarded or should have considered  
20 as red flags that indicated insolvency are the capitalization ratio, debt-service ratio, and  
cash ratio.

21 The *capitalization ratio* is the Company's total debt divided by the sum of total  
22 debt and total equity. After consolidation, the capitalization of Mortgages Ltd. grew from  
91.4% financed by debt to 99.6% financed by debt. In other words, the Company was  
capitalized in all material respects by borrowed money.

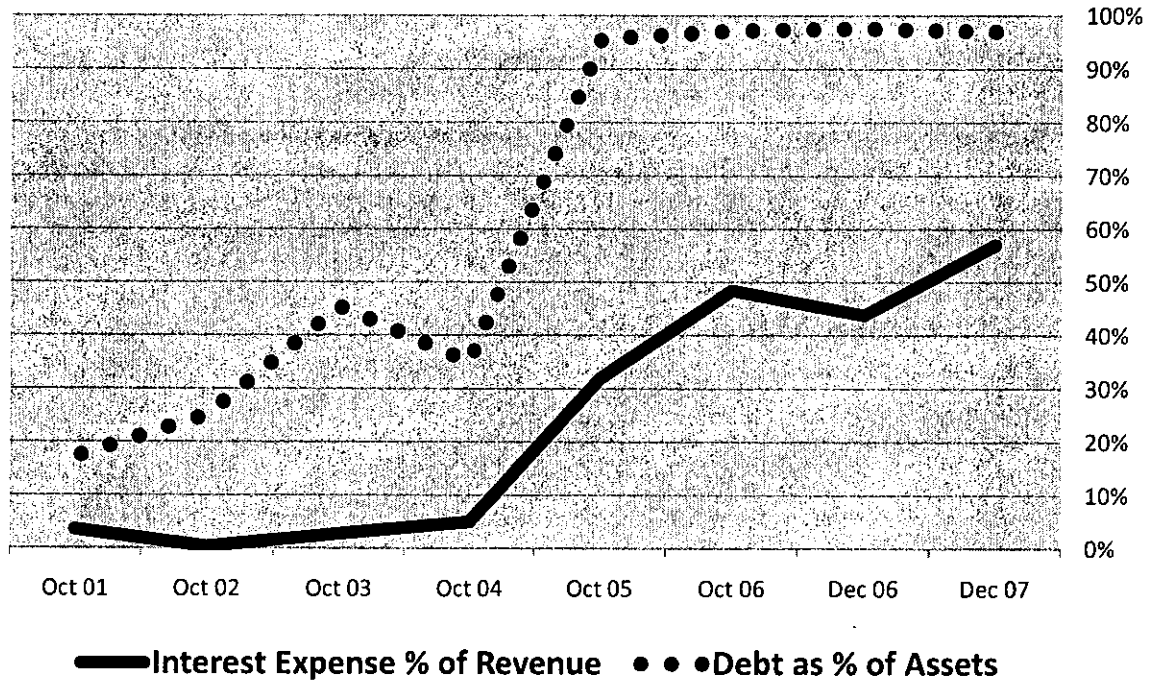
23 The *debt-service ratio* of total debt divided by net income shows the number of  
24 years of current earnings that are needed to retire outstanding debt. In 2005, the debt-  
service ratio jumped from 6 years of earnings to pay off debt to over 33 years.

25 The *cash ratio* of cash divided by current liabilities measures the liquidity of a  
26 company and the ability of available cash to meet the needs of current obligations coming  
due. After consolidating the October 31, 2005 financials, the cash ratio of 0.03 means  
that current cash levels only cover 3% of current liabilities. Or in dollar terms, there was  
only enough cash to pay \$3 for every \$100 of current liabilities outstanding.



1 exceeded the Company's assets.

2 **Table 6 — Debt Ratios and Interest Expense by Year**



14

15 361. As described above in paragraphs 355-57, Mortgages Ltd. was balance-

16 sheet insolvent in 2006 and 2007, and its financial conditions in 2005 raised substantial

17 doubt about its ability to operate without a continuing pipeline of mounting debt from

18 new investors. Yet contrary to AU section 341, Mayer Hoffman issued unqualified audit

19 reports for 2005, 2006, and 2007.

20 362. These reports, which contained neither a going-concern qualification, nor

21 any disclosure regarding the issue, (a) rendered untrue Mayer Hoffman's representation

22 that it had audited Mortgages Ltd. in accordance with GAAS, and (b) misled investors

23 and their financial advisors about the Company's financial stability.

24 **7. The financial statements were materially incomplete and**

25 **misleading regarding the Company's valuation practices and**

26 **writedowns.**

363. Mayer Hoffman knew that Mortgages Ltd.'s business was real-estate driven

1 and that management's estimates of the real estate and mortgage investments that it  
2 owned were particularly sensitive. This was so because of the significance of these  
3 estimates to the financial statements and possible changes in value caused by the real-  
4 estate market.

5 364. Mayer Hoffman realized and noted in March 2006 and March 2007  
6 memorandums to Mortgages Ltd.'s directors that disclosures regarding the Company's  
7 mortgage investments were among the "most sensitive estimates" in the Company's  
8 financial statements.

9 365. Loan files and records made available to Mayer Hoffman during its audits  
10 showed that Mortgages Ltd. did not follow normal mortgage-industry practices in the  
11 Company's loan-underwriting decisions. For example,

- 12 • The files showing loan-approval decisions contain only a brief  
13 description of the project, the borrower, and the collateral taken on  
the loan.
- 14 • The files contain little repayment analysis of the borrowers or  
15 guarantors.
- 16 • No financial spreads of borrower or guarantor tax returns or  
17 financial statements were performed.
- 18 • Personal financial statements on guarantors were obtained, but the  
19 assets reported were not verified by file documentation. Thus, cash  
20 and liquidity shown on borrowers' asset schedules was not verified  
21 with bank statements or deposit information.
- 22 • Many personal financial statements indicated future values that were  
supported by the real-estate project's estimated completion value  
rather than the property's value at of the date of the financial  
statement.
- 23 • Independent appraisals were not typically required.

24 366. In addition to knowledge of these risk-heightening underwriting practices,  
25 Mayer Hoffman's communications with Mortgages Ltd.'s directors show that it knew  
26 that rather than follow reliable industry practices in valuing its real-estate assets,  
Mortgages Ltd. had "no policies and procedures in place that provide for regular reviews

1 by management of the potential impairment of real estate” assets held by the Company.  
2 The same documents also show Mayer Hoffman knew that unlike most well-managed  
3 companies, Mortgages Ltd. did not have any procedure for annual or other periodic  
4 reviews through appraisers, analysis of recent sales of comparable properties, or other  
5 valuation techniques that are common practice in the real-estate industry. Mayer  
6 Hoffman’s March 28, 2008 memorandum to Mortgages Ltd.’s board of directors shows  
7 that it knew and identified this as a material weakness in Mortgages Ltd.’s internal-  
8 accounting system and the reliability of its financial statements. The same material  
9 weakness existed when the earlier 2005 and 2006 audits occurred.

10 367. Mayer Hoffman also knew that the Company in large part based its  
11 valuations (and its decision not to record loss reserves for impaired real-estate assets) on  
12 historical collections. That is, the Company claimed its historical performance in  
13 recapturing principal lent to borrowers on behalf of investors demonstrated that a loss  
14 reserve for impairment was unneeded.

15 368. Mayer Hoffman knew that extrapolating real-estate values from loan  
16 collections was not a recognized valuation methodology. It noted in its March 28, 2007  
17 internal-controls memorandum that it had not subjected the Company’s position to  
18 auditing procedures. Even so, Mayer Hoffman knew from its familiarity with Mortgages  
19 Ltd.’s loan files that the Company carelessly evaluated the creditworthiness of its  
20 borrowers and guarantors and did follow industry standards in making its loan-  
21 underwriting decisions. *See supra* ¶ 365. Mayer Hoffman also knew or should have  
22 known from its impairment and collateral testing that Mortgages Ltd. systematically  
23 rewrote loans to extend their maturity rather than declare a default. Mayer Hoffman also  
24 knew or negligently ignored that by 2007, the entire country was experiencing a steep  
25 decline in real-estate prices.

26 369. As a result of the facts just described, the real-estate values for loans

1 underwritten by Mortgages Ltd. were impaired and the value of real-estate assets reported  
2 on Mortgages Ltd.'s balance sheet was overstated. Specifically, Plaintiffs are informed  
3 and believe that by December 31, 2007—

- 4 • At least 31 individual loan balances exceeded the fair market value  
5 of the collateral that secured the loans.
- 6 • Collectively, these loans exceeded the market value of the collateral  
7 for the loan balances by approximately \$193 million.
- 8 • Of this \$193 million, Mortgages Ltd.'s share of the impaired value  
9 was \$42.5 million as of May 31, 2008. The remaining \$150.5  
10 million was the share securing investor loans.

11 370. The information that forms the basis for Plaintiffs' belief is contained in (a)  
12 regulatory findings made by the Arizona Department of Financial Institutions (AzDFI) in  
13 connection with the revocation of Mortgages Ltd.'s mortgage license and (b) the  
14 Examiner's Report on which the findings were based.

15 371. The AzDFI examined Mortgages Ltd.'s May 31, 2008 balance sheet and  
16 spent five weeks assessing the quality and value of Mortgages Ltd.'s real-estate portfolio.  
17 AzDFI found multiple GAAP violations and concluded that Mortgages Ltd.'s balance-  
18 sheet entry for mortgage investments was stated at cost, which exceeded fair-market  
19 value by \$42.5 million.

20 372. If the mortgages held for investments had been stated at fair-market value,  
21 Mortgages Ltd. would have shown a negative net equity rather than the positive \$9.8  
22 million shown on the May 31, 2008 balance sheet. That is, \$42.5 million minus \$9.8  
23 million equals <\$32.7 million>.

24 373. The overvaluation of mortgage investments on Mortgages Ltd. May 31,  
25 2008 balance sheet and that on the December 31, 2007 balance sheet that Mayer Hoffman  
26 audited are not materially different as to the insolvency (negative-equity) analysis

1 conducted by the AzDFI.<sup>35</sup> Mortgage investments on the December 31, 2007 and May  
2 31, 2008 balance sheets are respectively \$304 million and \$285 million. And the equity  
3 reported on the balance sheets was respectively \$8.2 million (12/31/07) and \$9.8 million  
4 (5/31/07). Mortgages Ltd. did not originate any new loans in 2008. It stopped  
5 originating new loans in 2007. All of the 31 loans that AzDFI determined were impaired  
6 were outstanding at December 31, 2007.

7 374. Although the value of these 31 loans was impaired as of December 31,  
8 2007, Mortgages Ltd.'s audited 2007 financial statements did not include a writedown or  
9 loss reserve to cover the impaired value. Despite this and in violation of GAAP (FAS  
10 107 & 157),<sup>36</sup> Mayer Hoffman issued a clean audit report for 2007 that misrepresented  
11 the fair value of Mortgages Ltd.'s real-estate assets and misled investors and their  
12 financial advisors.

13 375. All five of the mega loans in Table 1 (¶ 105) were listed as impaired. For  
14 example, loans to the Grace Entities (Vento) were impaired by \$60 million. Loans to  
15 Central Phoenix Partners were impaired by \$6.6 million. And loans to the University and  
16 Ash borrowers were impaired by \$24 million.

17 **D. CBIZ's Role**

18 376. As a public company, CBIZ, Inc. cannot provide audit and other attest  
19 services.

20 377. Rather than give up the profits from attest work, CBIZ and its subsidiary,  
21 CBIZ MHM, LLC (collectively "CBIZ") joint venture with Mayer Hoffman, a nonpublic  
22 company controlled by CBIZ. As a result of the joint venture, CBIZ is able to provide its  
23 clients with attest as well as other professional services (e.g., tax solutions, business  
24 consulting, and employee services).

25  
26 <sup>35</sup> The accounts on the two balance sheets are not materially different.

<sup>36</sup> Cited *supra* notes 18-19.

1           378. Although nominally separate to satisfy professional standards required for  
2 auditor independence, CBIZ and Mayer Hoffman operate as one business under which  
3 CBIZ and Mayer Hoffman jointly market themselves as the country's eight largest  
4 accounting and professional-services firm.

5           379. As a component of their relationship, CBIZ and Mayer Hoffman are parties  
6 to an Administrative Services Agreement under which revenues are divided and expenses  
7 allocated. The two companies also maintain a joint-referral relationship designed to  
8 mutually benefit both CBIZ and the CPAs who work through Mayer Hoffman by  
9 increasing the size of both parties' client base.

10           380. The joint venture provides the CBIZ employees who work as auditors with  
11 (a) the capital and resources of a national firm, (b) access to national training programs,  
12 and (c) the reputational stature of working in a national professional-services firm. CBIZ  
13 in turn is able to use the Mayer Hoffman name to provide (and profit from) an attestation  
14 business unit. Under the terms of the joint venture, CBIZ receives nearly all of the profits  
15 from the attest work as well as cross-work from attest clients who use CBIZ's services in  
16 other areas such as tax work, financial-advisory services (e.g., valuations), and employee  
17 services (e.g., benefits, retirements, and recruiting).

18           381. CBIZ controls the prices charged for the venture's attest services. It also  
19 controls all material costs incurred in delivering the attest services.

20           382. The CPAs who perform audits under the Mayer Hoffman name are  
21 employees and agents of CBIZ who, as more fully explained below, are entirely  
22 dependent on CBIZ for their compensation, staff, and continued employment.

23           383. CBIZ's control of Mayer Hoffman is illustrated by the fact that for the two  
24 years spanning August 1, 2006 to July 31, 2008, Mayer Hoffman retained as profits only  
25 \$62,000 on each \$1 million of revenue that its attest services produced. The remaining  
26 profits flowed to CBIZ, which received 85% of Mayer Hoffman's gross revenue and

1 required Mayer Hoffman to use nearly all of the remaining 15% to cover operating  
2 expenses that supported the attest revenue that flowed to CBIZ. Thus, CBIZ required  
3 Mayer Hoffman to pay the following expenses from Mayer Hoffman's 15% of the attest  
4 revenue: expenses for continuing CPA education, professional-liability insurance, and  
5 professional licensing fees. In short, Mayer Hoffman was and is a financially controlled  
6 company that CBIZ uses to channel to itself the profits from audit and other attest work  
7 that CBIZ is otherwise prohibited from receiving. Nearly all of the little revenue that  
8 Mayer Hoffman has is revenue that it is contractually required to spend for expenses that  
9 support the profits from attest work that flow to CBIZ.

10 384. CBIZ makes the decision on what CPAs are available to staff Mayer  
11 Hoffman's audits and has the right to hire, fire, and relocate the CPAs. CBIZ also  
12 controls the billing rates for all audit and other attest services.

13 385. For the 2005, 2006, and 2007 Mortgages Ltd. audits, all of the CPAs doing  
14 the attest work were CBIZ employees. These CPAs' salaries, raises, bonuses, and other  
15 employment benefits are and were controlled by CBIZ. Similarly, the staff, office space,  
16 and nearly all other support resources needed for the 2005-07 audit work were provided  
17 and controlled by CBIZ.

18 386. Although the CPAs who perform audit work are also designated as Mayer  
19 Hoffman employees, they receive no salaries, bonuses, retirement benefits, dividends, or  
20 other financial remuneration from Mayer Hoffman. Nor do they receive a W-2 from  
21 Mayer Hoffman. Instead, the only W-2s and the only compensation that they receive  
22 comes from CBIZ. The CBIZ employees became Mayer Hoffman employees only by  
23 virtue of entering into a Mayer-Hoffman stockholder agreement that CBIZ requires.

24 387. These stockholder agreements benefit CBIZ by including noncompetition,  
25 nonsolicitation, and nondisclosure provisions that CBIZ has the contractual right to  
26 enforce by suing for both injunctive relief and damages.

1           388. All money for services from attest clients is banked by CBIZ, which bills  
2 and collects money that is owed by the attest clients. Thus, bills for Mayer Hoffman's  
3 work on Mortgages Ltd. audits were invoiced to Mortgages Ltd. by the Phoenix office of  
4 CBIZ MHM, LLC. The invoices instructed Mortgages Ltd. to make payment to a CBIZ  
5 MHM office in Los Angeles.

6           389. The CBIZ and Mayer Hoffman personnel in Phoenix and other offices  
7 share the same space with the same entrance and a common receptionist. In Phoenix, the  
8 same managing partner, Joel Kramer, oversees the CBIZ practice and the Mayer Hoffman  
9 practice. The audit partners for the 2005, 2006, and 2007 audits reported to Mr. Kramer,  
10 who does not himself maintain an audit practice.

11           390. All employees use CBIZ business cards including the CPAs providing  
12 attest functions (they do not use Mayer Hoffman business cards).

13           391. Because of the control that CBIZ has, it was required to establish a  
14 reasonable system of supervision designed to ensure competent audits by the employees  
15 it controls. Rather than fulfill this supervisory responsibility, CBIZ improperly and in  
16 violation of the protective purposes of Arizona's securities laws purports to (a) treat its  
17 CPA-employees as independent contractors when they perform audits and (b) disclaim  
18 responsibility for the attest services for which they are paid by CBIZ.

19           **E. Tender**

20           392. Individually and on behalf of the proposed Classes, Plaintiffs tender to  
21 Defendants all consideration received in connection with the securities that Plaintiffs  
22 purchased and offer to do any other acts necessary for rescission under the common law  
23 or A.R.S. § 44-2001(A). In return, Plaintiffs demand rescission with interest and attorney  
24 fees as provided in A.R.S. § 44-2001(A).

25

26



1 **V. Legal Claims**

2 **Count One**

3 **(Primary Statutory Liability Under A.R.S. § 44-2003(A))**

4 393. Plaintiffs incorporate the preceding allegations.

5 394. The investments sold by Mortgages Ltd. and Radical Bunny under the ML-  
6 RB Joint Venture were securities under Arizona and federal law.

7 395. Through the ML-RB Joint Venture, Mortgages Ltd. and Radical Bunny  
8 jointly engaged in the unlawful integrated sale of securities to Plaintiffs and other Class  
9 members in violation of A.R.S. §§ 44-1991(A)(1) and (3).

10 396. Through the ML-RB Joint Venture, Mortgages Ltd. and Radical Bunny  
11 jointly made misleading representations and omissions in connection with the integrated  
12 sale of securities in violation of A.R.S. § 44-1991(A)(2). *See, e.g., supra* ¶¶ 86-87, 91,  
13 200, 204-09, 353, 362, and 374.

14 397. Defendant Greenberg violated A.R.S. § 44-1991(A)(1), (2), and (3) and  
15 participated in or induced the unlawful integrated securities sales to Plaintiffs Facciola,  
16 Reznik, Hagel, Baker, and other members of the proposed Classes, within the meaning of  
17 A.R.S. § 44-2003(A).

18 398. Defendant Quarles violated A.R.S. § 44-1991(A)(1), (2), and (3) and  
19 participated in or induced the unlawful integrated securities sales to Plaintiffs Facciola,  
20 Reznik, Hagel, Baker, and other members of the proposed Classes, within the meaning of  
21 A.R.S. § 44-2003(A).

22 399. Defendant Mayer Hoffman violated A.R.S. § 44-1991(A)(2) and (3) and  
23 participated in or induced the unlawful integrated securities sales to Plaintiffs Facciola,  
24 Reznik, Hagel, Baker, and other members of the proposed Classes, within the meaning of  
25 A.R.S. § 44-2003(A).

26 400. Defendants Denning, Brown, Newman, and Olson violated A.R.S. § 44-

1 1991(A)(1), (2), and (3) and participated in or induced the unlawful integrated securities  
2 sales to Plaintiffs Facciola, Reznik, Hagel, Baker, and other members of the proposed  
3 Classes, within the meaning of A.R.S. § 44-2003(A).

4 401. Defendants Hirsch, the Walders, and Shah violated A.R.S. § 44-  
5 1991(A)(1), (2), and (3) and participated in or induced the unlawful integrated securities  
6 sales to Plaintiffs Facciola, Reznik, Hagel, Baker, and other members of the proposed  
7 Classes, within the meaning of A.R.S. § 44-2003(A).

8 402. Defendants Greenberg, Quarles, Mayer Hoffman, Denning, Brown,  
9 Newman, Olson, Hirsch, the Walders, and Shah are, under A.R.S. § 44-2003(A), jointly  
10 and severally liable to the same extent as Mortgages Ltd. and Radical Bunny for the  
11 unlawful sales and violations of A.R.S. § 44-1991(A). Except for their bankruptcy,  
12 Mortgages Ltd. and Radical Bunny would also be jointly and severally liable under  
13 section 44-2003(A).

14 403. Under A.R.S. § 44-2001(A), Defendants Greenberg, Quarles, Mayer  
15 Hoffman, Denning, Brown, Newman, Olson, Hirsch, the Walders, and Shah are liable for  
16 rescission (as to violations of 44-1991(A)(1) and (3)) or damages (as to violations of 44-  
17 1991(A)(2)) plus costs, attorney fees, and pre and post-judgment interest.

## 18 **Count Two**

### 19 **(Statutory Control Liability Under A.R.S. § 44-1999(B))**

20 404. Plaintiffs incorporate the preceding allegations.

21 405. Through the ML-RB Joint Venture, Mortgages Ltd. violated A.R.S. § 44-  
22 1991(A). Except for its bankruptcy, Mortgages Ltd. would be held liable under § 44-  
23 2003(A) for its unlawful sales and violations of section 44-1991(A).

24 406. Individually and as a group, Defendants Denning, Brown, Newman, and  
25 Olson controlled Mortgages Ltd. within the meaning of A.R.S. § 44-1999(B) when  
26 Mortgages Ltd.'s violations of § 44-1991(A) occurred. As statutory controlling persons

1 of Mortgages Ltd., Defendants Denning, Brown, Newman, and Olson are jointly and  
2 severally liable under A.R.S. § 44-1999(B) for Mortgages Ltd.'s unlawful sales and  
3 violations of section 44-1991(A).

4 407. Through the ML-RB Joint Venture, Radical Bunny violated A.R.S. § 44-  
5 1991(A). Except for its bankruptcy, Radical Bunny would be held liable under 44-  
6 2003(A) for its unlawful sales and violations of § 44-1991(A).

7 408. Individually and as a group, Defendants Hirsch, the Walders, and Shah  
8 controlled Radical Bunny within the meaning of A.R.S. § 44-1999(B) when Radical  
9 Bunny's violations of § 44-1991(A) occurred. As statutory controlling persons of  
10 Radical Bunny, Hirsch, the Walders, and Shah are jointly and severally liable under  
11 A.R.S. § 44-1999(B) for Radical Bunny's unlawful sales and violations of 44-1991(A).

12 409. As a group, Defendants Denning, Brown, Newman, Olson, Hirsch, the  
13 Walders, and Shah controlled the ML-RB Joint Venture within the meaning of A.R.S.  
14 § 44-1999(B) when the Joint Venture's violations of § 44-1991(A) occurred.<sup>37</sup> As  
15 statutory controlling persons of the Joint Venture, Denning, Brown, Newman, Olson,  
16 Hirsch, the Walders, and Shah are jointly and severally liable under A.R.S. § 44-1999(B)  
17 for the Joint Venture's unlawful sales and violations of section 44-1991(A).

18 410. As alleged in Count One, Mayer Hoffman committed violations of A.R.S.  
19 § 44-1991(A) for which it is primarily liable under A.R.S. § 44-2003(A).

20 411. Individually or in combination, CBIZ, Inc. and CBIZ MHM, LLC  
21 controlled Mayer Hoffman within the meaning of A.R.S. § 44-1999(B) when Mayer  
22 Hoffman's violations of § 44-1991(A) occurred. As statutory controlling persons under  
23 A.R.S. § 44-1999(B), CBIZ, Inc. and CBIZ MHM, LLC are jointly and severally liable  
24 for Mayer Hoffman's violations of 44-1991(A).

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25  
26 <sup>37</sup> Except for the bankruptcies of Mortgages Ltd. and Radical Bunny, the Joint  
Venture would be held liability for its unlawful sales and violations of A.R.S. § 44-  
1991(A).

1 412. Accordingly, under this Count, Defendants Greenberg, Quarles, Mayer  
2 Hoffman, CBIZ, Inc., CBIZ MHM, LLC, Denning, Brown, Newman, Olson, Hirsch, the  
3 Walders, and Shah are liable as statutory control persons for rescission (as to violations  
4 of 44-1991(A)(1) and (3)) or damages (as to violations of 44-1991(A)(2)) plus costs,  
5 attorney fees, and pre and post-judgment interest.

6 **Count Three**

7 **(Aiding and Abetting Statutory Securities Fraud)**

8 413. Plaintiffs incorporate the preceding allegations.

9 414. Through the ML-RB Joint Venture, Mortgages Ltd. and Radical Bunny  
10 committed violations of A.R.S. § 44-1991(A) in the integrated sale of securities to  
11 Plaintiffs and the Classes. Except for their bankruptcies, Mortgages Ltd. and Radical  
12 Bunny would be liable under § 44-2003(A) for their unlawful sales and violations of  
13 § 44-1991(A).

14 415. Defendants Greenberg and Quarles knowingly and substantially assisted the  
15 securities law violations by Mortgages Ltd., Radical Bunny, and the ML-RB Joint  
16 Venture despite knowing (or willfully disregarding), among other things, that

- 17
- Radical Bunny was violating the registration and disclosure provisions of Arizona and federal securities law.
  - Those violations were not being disclosed to Mortgages Ltd. and Radical Bunny investors like Plaintiffs and the proposed Classes.
  - Radical Bunny and Mortgages Ltd. were perpetrating a Ponzi scheme.
- 21

22 416. Defendants Denning, Brown, Newman, and Olson knowingly and  
23 substantially assisted the securities law violations by Mortgage Ltd., Radical Bunny, and  
24 the ML-RB Joint Venture despite knowing (or willfully disregarding), among other  
25 things, that

- 26
- Radical Bunny was violating the registration and disclosure provisions of Arizona and federal securities law.

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- Those violations were not being disclosed to Mortgages Ltd. and Radical Bunny investors like Plaintiffs and the proposed Classes.
- Radical Bunny and Mortgages Ltd. were perpetrating a Ponzi scheme.

417. Defendants Hirsch, the Walders, and Shah knowingly and substantially assisted the securities law violations by Mortgage Ltd., Radical Bunny, and the ML-RB Joint Venture despite knowing (or willfully disregarding), among other things, that

- Radical Bunny was violating the registration and disclosure provisions of Arizona and federal securities law.
- Those violations were not being disclosed to Mortgages Ltd. and Radical Bunny investors like Plaintiffs and the proposed Classes.
- Radical Bunny and Mortgages Ltd. were perpetrating a Ponzi scheme.

418. Accordingly, under this Count, Defendants Greenberg, Quarles, Mayer Hoffman, Denning, Brown, Newman, Olson, Hirsch, the Walders, and Shah are liable for rescission (as to violations of 44-1991(A)(1) and (3)) or damages (as to violations of 44-1991(A)(2)) plus costs, attorney fees, and pre and post-judgment interest.

**Count Four**

**(Aiding and Abetting Breach of Fiduciary Duties)**

419. Plaintiffs incorporate the preceding allegations.

420. Under the POMs prepared by Greenberg, Mortgages Ltd. was a manager or agent with fiduciary discretion to act acting on behalf of its investors. The Company's investors were dependent on Mortgages Ltd. for the managerial skill needed to run the Company.

421. Similarly, Radical Bunny was an agent or manager acting on behalf of its investors, whom Hirsch and his partners called the Radical Bunny family. Mortgages Ltd. was Radical Bunny's co-venturer and agent in connection with these offerings.

1 422. As managers or agents of the ML-RB Joint Venture, Mortgages Ltd. and  
2 Radical Bunny owed Plaintiffs and other investors in the proposed Classes fiduciary  
3 duties of full disclosure, loyalty, good faith, and fairness.

4 423. Individually and as joint venturers, Mortgages Ltd. and Radical Bunny  
5 breached their fiduciary duties of disclosure, loyalty, good faith, and fairness by  
6 conducting a Ponzi scheme and failing to disclose to Class members, among other things,  
7 the materially adverse facts described in paragraphs 86-87, 91, 200, 204-09, 353, 362,  
8 and 374 and the deceptive and unfair acts and course of business described in Part IV(A).

9 424. Defendants Denning, Brown, Newman, Olson, Hirsch, the Walders, Shah,  
10 Greenberg, and Quarles each knowingly aided and abetted and participated in the  
11 fiduciary breaches by Mortgages Ltd., Radical Bunny, and the ML-RB Joint Venture.

12 425. Plaintiffs and the proposed Classes were damaged (and were induced to  
13 buy or retain their securities) by Defendants' aiding and abetting and participation in the  
14 fiduciary nondisclosure and other misconduct described in this Count.

15 426. In addition to compensatory damages, Plaintiffs are entitled to punitive  
16 damages.

17 **Count Five**

18 **(Negligent Misrepresentation and Nondisclosure)**

19 427. Plaintiffs incorporate the preceding allegations.

20 428. Defendant Greenberg negligently gathered, compiled, and communicated  
21 information in the POMs through which Mortgages Ltd.'s unlawfully sold securities to  
22 Plaintiffs and members of the proposed Class of Mortgages Ltd. investors. *See, e.g.,*  
23 *supra* ¶¶ 86-87, 91, 200, 204-09, 353, 362, and 374.

24 429. Defendant Quarles negligently gathered, compiled, and authorized the  
25 distribution of information used in the investor meetings and materials through which  
26 Radical Bunny unlawfully offered, sold, or described securities to Plaintiffs and members

1 of the proposed Class of Radical Bunny investors. *See, e.g., supra* ¶¶ 150, 153-55, 161-  
2 66, 172-73, 180-85, 196, 250-52, 258-65, 271-72, 275-76, 284, and 287-89.

3 430. Defendant Mayer Hoffman negligently gathered, compiled, and  
4 communicated information in its audit reports for 2005, 2006, and 2007 through which  
5 Mortgages Ltd., Radical Bunny, and the ML-RB Joint Venture engaged in the unlawful  
6 integrated sale of securities to Plaintiffs and members of both proposed Classes. In  
7 connection with its audits, Mayer Hoffman negligently misrepresented Mortgages Ltd.'s  
8 financial condition and negligently represented that the financial statements were audited  
9 in accordance with GAAS and were presented in conformity with GAAP. This was done  
10 even though Mayer Hoffman had full knowledge that these reports would be submitted to  
11 and relied upon by existing and prospective Mortgages Ltd. and Radical Bunny investors  
12 as well as the financial advisors and agents of the investors.

13 431. Other negligent misrepresentations in Mayer Hoffman's 2005, 2006, and  
14 2007 audit reports include falsely representing that,

- 15 • Mortgages Ltd.'s financial statements complied with GAAP even  
16 though, contrary to FIN 46, Mortgages Ltd.'s financial statements  
17 were presented without consolidating the limited-liability companies  
18 through which Mortgages Ltd. raised money.
- 18 • Mortgages Ltd.'s financial statements complied with GAAP even  
19 though, contrary to FAS 57,<sup>38</sup> Radical Bunny was not identified as a  
20 related party and all material transactions between Radical Bunny  
21 and Mortgages Ltd. were not disclosed.
- 20 • Mortgages Ltd.'s financial statements complied with GAAP even  
21 though Mortgages Ltd. (a) did not report its real-estate assets at fair  
22 value as required by FAS 157<sup>39</sup> and (b) had failed to disclose the  
23 fair-value methods used in valuation as required by FAS 107.<sup>40</sup>

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23 <sup>38</sup> FASB Accounting Standards Codifications Subtopic 850-10, Related Party  
24 Disclosures (codifying Statement of Financial Accounting Standards No. 57).

25 <sup>39</sup> FASB Accounting Standards Codifications Subtopic 820-10, Fair Value  
26 Measurements and Disclosures (codifying Statement of Financial Accounting Standards  
No. 157).

<sup>40</sup> FASB Accounting Standards Codifications Subtopic 820-10-50, Fair Value

1           432. In addition, Mayer Hoffman negligently:

- 2           • Misrepresented Mortgages Ltd.'s debt, leverage of assets and equity,  
3           interest expense, and lack of liquidity (*see supra* ¶¶ 343-45 and 356-  
4           58).
- 4           • Issued its audit reports with neither a going-concern qualification,  
5           nor any disclosure regarding the issue, which (a) rendered untrue  
6           Mayer Hoffman's representation that it had audited Mortgages Ltd.  
7           in accordance with GAAS, and (b) misled investors and their  
8           financial advisors about the Company's financial stability.
- 7           • Failed to disclose, in violation of GAAP (FAS 107 & 157), that 31  
8           of the Company's loans were impaired as of December 31, 2007 (*see*  
9           *supra* ¶¶ 369-75).
- 9           • Represented that Mortgages Ltd.'s audited 2007 financial statements  
10          were presented in conformity with GAAP even though the financial  
11          statements did not include a writedown or loss reserve to cover the  
12          impaired value as required by FAS 107 & 157.

12           433. The Defendants named in this Count, in the course of their business,  
13          profession, or employment, thus supplied false information for the guidance of the named  
14          Plaintiffs and other members of the proposed Classes in their business transactions  
15          relating to the purchase and retention of Mortgages Ltd.'s securities. These Defendants  
16          are therefore subject to liability for pecuniary loss caused to Plaintiffs and the Classes by  
17          their justifiable reliance upon the information, because these Defendants failed to  
18          exercise reasonable care or competence in gathering or communicating that information.

19           434. Defendants' negligence damaged Plaintiffs and the Classes and caused their  
20          losses.

21           435. If Mortgages Ltd.'s true financial condition had been disclosed in the  
22          POMs, RB Offering Documents, and the audited 2005, 2006, and 2007 financial  
23          statements, the securities sold by Mortgages Ltd. and Radical Bunny would have been  
24          unsalable and worthless.

25  
26          Measurements and Disclosures (codifying Statement of Financial Accounting Standards  
No. 107).



1 **Count Six**

2 **(Primary Statutory Liability Under A.R.S. § 44-3241)**

3 436. Plaintiffs incorporate the preceding allegations.

4 437. This Count arises under section 44-3241(A)-(B) of the Arizona Investment  
5 Management Act (AzIMA).

6 438. The transactions in which Plaintiffs and members of the proposed Classes  
7 purchased and held their investments involved the provision of investment advisory  
8 services within the scope of the AzIMA. As to the Class of Mortgages Ltd. investors,  
9 these investment advisory services were provided by salespersons who worked as  
10 managing directors through ML Securities. As to the Class of Radical Bunny investors,  
11 these investment advisory services were provided by Radical Bunny, an unlicensed  
12 securities dealer, and its management, i.e., Defendants Hirsch, the Walders, and Shah,  
13 who operated as unlicensed securities salespersons.

14 439. Mortgages Ltd. and Radical Bunny individually and jointly engaged in the  
15 unlawful provision of investment advisory services to Plaintiffs and other Class members  
16 in violation of A.R.S. §§ 44-3241(A)(1), (2), and (4).

17 440. The AzIMA extends liability not only to persons who violate section 44-  
18 3241(A) while providing investment-advisory services, but also to any person who,  
19 directly or indirectly, commits an act prohibited by section 44-3241 in connection with a  
20 transaction involving investment-advisory services. Accordingly, a defendant need not  
21 be an investment adviser to violate section 44-3241.

22 441. Defendants Greenberg, Quarles, and Mayer Hoffman committed acts  
23 prohibited by A.R.S. §§ 44-3241(A)(1), (2), or (4) in connection with transactions  
24 involving investment-advisory services, namely:

- 25 • Through the POMs that it prepared, Greenberg provided incomplete  
26 and misleading information that was used in connection with the  
investment advisory services that ML Securities (and its managing  
directors) provided to Mortgages Ltd. investors.

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- Through the disclosure materials that it prepared, Quarles provided incomplete and misleading information that was used in connection with the investment advisory services that Radical Bunny (and its managers) provided to Radical Bunny investors.
- Through the audit reports on Mortgages Ltd.'s financial statements for 2005, 2006, and 2007 that it prepared, Mayer Hoffman provided misleading information regarding the financial condition of Mortgages Ltd. that was used in connection with the investment advisory services that ML Securities and Radical Bunny provided to Plaintiffs and the proposed Classes.

442. The statutory violations of the AzIMA described in this Count damaged Plaintiffs and other members of the proposed Classes by causing them to purchase or hold their securities.

443. Plaintiffs are entitled to damages as provided in A.R.S. § 44-3241(B).

**Count Seven**

**(Aiding and Abetting Violations of A.R.S. § 44-3241)**

444. Plaintiffs incorporate the preceding allegations.

445. Defendants Greenberg and Quarles knowingly aided, abetted, and substantially assisted the ML-RB Joint Venture, Radical Bunny, and Mortgages Ltd. in the following ways (and other ways described above):

- Through the POMs that it prepared, Greenberg provided incomplete and misleading information that was used in connection with the investment advisory services that ML Securities (and its managing directors) provided to Mortgages Ltd. investors.
- Through the disclosure materials that it prepared, Quarles provided incomplete and misleading information that was used in connection with the investment advisory services that Radical Bunny (and its managers) provided to Radical Bunny investors.
- Through the audit reports on Mortgages Ltd.'s financial statements for 2005, 2006, and 2007 that it prepared, Mayer Hoffman provided misleading information regarding the financial condition of Mortgages Ltd. that was used in connection with the investment advisory services that ML Securities and Radical Bunny provided to Plaintiffs and the proposed Classes.

1 446. The statutory violations of the AzIMA described in this Count damaged  
2 Plaintiffs and other members of the proposed Classes by causing them to purchase or  
3 hold their securities.

4 447. Plaintiffs are entitled to damages as provided in A.R.S. § 44-3241(B).

5 **Count Eight**

6 **(Common-Law Secondary Liability of CBIZ Defendants)**

7 448. CBIZ, Inc., CBIZ MHM, LLC, and Mayer Hoffman were joint venturers in  
8 connection with the preparation and issuance of the audit reports for Mortgages Ltd.'s  
9 2005, 2006, and 2007 financial statements.

10 449. As members of a joint venture, CBIZ, Inc., CBIZ MHM, LLC, and Mayer  
11 Hoffman are jointly and severally liable for the damages caused by the acts and  
12 misconduct of one another that are alleged under Counts One, Five, and Six.

13 **Demand for Relief**

14 Therefore, Plaintiffs demand judgment against Defendants jointly and severally as  
15 follows:

- 16 A. Rescissionary or compensatory damages according to proof;  
17 B. Punitive damages in a just amount;  
18 C. Costs and attorneys' fees;  
19 D. Pre- and post-judgment interest; and  
20 E. Any other relief needed to provide Plaintiffs and other Class  
21 members with a complete remedy.

22 **Expert Testimony**

23 Plaintiffs certify under A.R.S. § 12-2602 that expert testimony is required to prove  
24 the negligence allegations against Mayer, Hoffman & McCann, P.C. Except as stated,  
25 expert testimony is not needed under A.R.S. § 12-2602.

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**Demand for Jury Trial**

Plaintiffs demand a trial by jury on all issues.

Dated: May 11, 2010.

**Tiffany & Bosco, P.A.**

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#15283-1 431054.doc

# Exhibit A

\$940 Million from 2000 Investors Financed Mgmts. Ltd.'s Business

