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IN THE SUPERIOR COURT OF THE STATE OF ARIZONA

IN AND FOR THE COUNTY OF MARICOPA

PETER S. DAVIS, as Receiver of DENSCO INVESTMENT CORPORATION, an Arizona corporation,

Plaintiff,

v.

U.S. BANK, NA. a national banking organization; HILDA H. CHAVEZ and JOHN DOE CHAVEZ, a married couple; JP MORGAN CHASE BANK, N.A., a national banking organization; SAMANTHA NELSON f/k/a SAMANTHA KUMBALECK and KRISTOFER NELSON, a married couple, and VIKRAM DADLANI and JANE DOE DADLANI, a married couple,

Defendants.

NO. CV2019-011499

DEFENDANTS JPMORGAN CHASE BANK, N.A., SAMANTHA NELSON, KRISTOFER NELSON, & VIKRAM DADLANI'S MOTION TO DISMISS COUNT TWO OF PLAINTIFF'S COMPLAINT

(Assigned to the Honorable Daniel Martin)

(Oral Argument Requested)

Defendants JPMorgan Chase Bank, N.A. ("Chase"), Samantha Nelson ("Ms. Nelson"), Kristofer Nelson, and Vikram Dadlani ("Mr. Dadlani") (collectively, along with Chase, the "Chase Defendants"), pursuant to Arizona Rules of Civil Procedure 9(b) and 12(b)(6), hereby move the Court to dismiss Count Two of the Complaint filed by Plaintiff DenSco Investment Corporation ("DenSco"), through Peter S. Davis (the "Receiver"), asserting a single claim against Chase for aiding and abetting a purported underlying fraud.

MEMORANDUM OF POINTS AND AUTHORITIES

DenSco, a lender, lost money in a multimillion dollar Ponzi scheme orchestrated by Scott Menaged ("Menaged") starting more than eight years ago. Believing that it was loaning money to Menaged's company, Arizona Home Foreclosures, LLC ("AZHF"), for the purchase of distressed real estate, DenSco alleges that Menaged, in typical Ponzi scheme fashion, used the DenSco loan funds to pay off prior loans and for personal expenses. Because DenSco admits that it knew of Menaged's fraud scheme at least as early as January 2014—but continued doing business with him anyway—and that the subject transactions at Chase ceased in June 2015, this action is time-barred on its face. Arizona law requires an aiding and abetting fraud claim to be asserted within three years, and this action was not filed until August 16, 2019. DenSco has alleged no factual basis to apply any tolling doctrine. Accordingly, DenSco's Complaint must be dismissed.

Aside from the fact that this matter is time-barred, DenSco's admitted knowledge of Menaged's fraud before a single transaction was conducted at Chase—compounded by its decision to continue doing business with AZHF after learning of the fraud—bars DenSco and the Receiver from recovering money from Chase in this action. In DenSco's action against Clark Hill PLC, DenSco admits that DenSco had full knowledge in January 2014 that Menaged and AZHF misappropriated DenSco loan funds and never used them to buy real estate, as promised. That was ***three months before*** Menaged opened the AZHF account at Chase. In other words, DenSco admits that: (i) DenSco learned that loan funds it sent Menaged and AZHF to purchase properties were ***not*** ultimately used by Menaged to purchase properties, as Menaged had promised; and (ii) DenSco learned this well before it sent even more loan money to AZHF's newly opened Chase account in April 2014 (illogically hoping/believing AZHF would use it as promised this time).

This knowledge defeats DenSco's attempt to assert an aiding and abetting fraud claim against the Chase Defendants. It is well-settled that before a plaintiff can state a viable aiding and abetting fraud action, it must first demonstrate the existence of an underlying fraud claim. A critical component of a fraud claim is ***justifiable*** reliance.

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Given DenSco's binding admissions as to when it uncovered AZHF's fraud and deceit, DenSco—as a matter of law—could not have justifiably relied on Menaged's subsequent representations that are the subject of this Complaint. DenSco's knowledge of Menaged's dishonesty renders any claim of reliance by this experienced investor wholly unjustified.

DenSco's claim also fails for other straightforward reasons. DenSco's allegations conflict with the settled principle that banks do not owe non-customers a duty to protect them from a bank customer's deals or fraud. Banks are not liable for aiding and abetting fraud simply because they bank and service an entity that ultimately defrauds those it does business with. Rather, a bank must possess actual knowledge of the relevant fraud scheme and provide substantial assistance to the fraudster to carry out that fraud. Stripped of all its speculative contentions, the Complaint fails to allege that the Chase Defendants had actual knowledge of Menaged's fraud or that the Chase Defendants had the "extraordinary" economic motivation required to plead substantial assistance. At most, DenSco's allegations—and any reasonable inferences to be drawn therefrom—reflect only that Menaged lied to the Chase Defendants about his transactions and that the transactions he engaged in were allegedly unusual. Nowhere does the Complaint specifically allege that Ms. Nelson or Mr. Dadlani—neither of whom should have been made a party to this case—knew of Menaged's fraudulent scheme to defraud and steal from DenSco. Similarly absent from the Complaint is a single allegation suggesting that the Chase Defendants had an extraordinary economic motivation to assist with the fraud, without which DenSco cannot plead the required element of substantial assistance.

To be sure, this is an unfortunate episode. But Chase, which merely served as AZHF's bank for a short period of time, is not at fault. Nor can Chase be subjected to a claim based on allegations that Chase "should have known" that Menaged was conducting a fraud. It is well-established that "should have known" is not tantamount to actual knowledge for purposes of pleading an aiding and abetting claim. Moreover, DenSco, the entity with actual knowledge that AZHF was defrauding it before even a single transaction occurred at Chase, should not now be permitted to look to recover losses from

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an entity that allegedly should have known of the fraud. That Menaged/AZHF performed bank transactions at Chase or that Chase may be thought of by the Receiver as another deep pocket for a potential DenSco recovery does not morph Chase into a blameworthy party with liability for investor losses. DenSco opted to deal with Menaged and AZHF in the first instance and continued to do so even after DenSco discovered their fraud. The Chase Defendants—who neither knew of nor substantially assisted Menaged in his fraud—are not liable for DenSco's ensuing losses.

FACTS ALLEGED BY DENSCO[1]

I. The DenSco/Menaged Business Relationship and Alleged Fraud

DenSco alleges that it began doing business with Menaged approximately eight years ago. (Compl., ¶ 81.) DenSco made short-term "hard money loans" for the purchase of foreclosed homes sold at trustee's sales. DenSco charged its borrowers 15–18% interest for the loans, which were to be secured by a deed of trust recorded against the purchased property. (*Id.* ¶ 1.) Menaged held himself out to be a purchaser of foreclosed homes and went to DenSco to borrow money to purchase properties. (*Id.* ¶ 17–18.)

Menaged allegedly defrauded DenSco by using the funds DenSco loaned to AZHF for his own personal use, instead of for purchasing foreclosed homes. (*Id.* ¶ 19.) In Densco's complaint against Clark Hill PLC (DenSco's law firm), DenSco admitted that it was aware that Menaged was defrauding DenSco by no later than January 2014—three months before AZHF began banking with Chase. DenSco expressly admits that it became aware that Menaged "had fraudulently obtained from DenSco as many as 125 loans that were not secured by a first-position deed of trust." (*Peter S. Davis, as Receiver for DenSco Inv. Corp. v. Clark Hill PLC*, Case No. 2017-013832, Dkt. No. 1, attached hereto as **Exhibit 1**, at ¶¶ 3, 54.)[2]

[1] The Chase Defendants treat DenSco's allegations against the Chase Defendant as true only for purposes of this Motion. *See Cullen v. Auto-Owners Ins. Co.*, 218 Ariz. 417, 419 ¶ 7, 189 P.3d 344, 346 (2008) (en banc).

[2] "[T]he Court can take judicial notice of [the] court file in [another] case without converting the Motion to Dismiss to a motion for summary judgment." *Calhoun v. Waesche*, No. CV 2013-016208, 2014 Ariz. Super. LEXIS 914, at *1 (Super. Sep. 10, 2014); *see also Bailey v. Hermanson*, No. C2012-2259, 2012 Ariz. Super. LEXIS 1517,

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DenSco alleges that to perpetrate fraud on DenSco, Menaged would misrepresent in emails to DenSco that he won property bids at a trustee's sale and that his company, AZHF, needed financing to purchase the properties, which he identified by address. Menaged would request DenSco to loan him a specific amount to purchase the homes. (Compl., ¶¶ 21–22.) But DenSco alleges that Menaged did not purchase the properties, and instead used the DenSco loan proceeds for his personal benefit. (*Id.* ¶¶ 25, 30.) In October 2017, Menaged pleaded guilty to bank fraud, identity theft, and money laundering charges and was sentenced to seventeen years in prison. (*Id.* ¶¶ 34–35.)

II. The Allegations Relating to Chase

Although DenSco alleges that Menaged's fraud began in December 2012, it was not until April 2014 that Menaged opened an account for AZHF at Chase. (*Id.* ¶ 87.) DenSco alleges that the Chase Defendants aided and abetted Menaged in defrauding DenSco based on Menaged's representations—made from April 2014 through June 2015—that AZHF would use the DenSco loan funds to buy properties. But DenSco concedes in its parallel complaint against Clark Hill that it knew of AZHF's fraud by no later than January 6, 2014. (*See* Ex. 1, at ¶¶ 3, 54.)

DenSco alleges that Chase branch employees Ms. Nelson and Mr. Dadlani were Menaged's main contacts at the Chase branch in Scottsdale where Menaged banked. (Compl., ¶¶ 89–90.) DenSco alleges that it would wire loan money to Menaged's AZHF account at Chase so that AZHF could purchase foreclosed homes. DenSco contends that the Chase Defendants knew that nearly all the funds in the AZHF account consisted of DenSco loan proceeds because of the incoming wire details. (*Id.* ¶¶ 97–98.)

With respect to the banking transactions occurring at Chase between April 2014

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at *22–23 (Super. Nov. 7, 2012) ("In considering the sufficiency of the complaint, the court may take judicial notice of its own and other records, including for actions involving similar parties and issues and of pleadings therein. Therefore, the Court may take judicial notice of Plaintiffs prior legal proceeding, pleadings, rulings, and judgments when considering this motion to dismiss") (citing *Regan v. First Nat'l Bank*, 55 Ariz. 320, 327, 101 P.2d 214, 217 (1940) (noting that the Arizona Supreme Court has held "that courts take judicial notice of other actions involving similar parties and issues and of the pleadings therein, and that in passing upon the pleadings in one action they may and should consider the record in the other")).

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and June 2015, (*id.* ¶ 133), DenSco alleges that after DenSco wired funds, Menaged would email Ms. Nelson and Mr. Dadlani and request them to issue cashier's checks from his AZHF account. DenSco alleges that Menaged directed the checks to be made payable to trustees in Arizona and in the amounts of the purported purchase prices, less $10,000 that Menaged was required to deposit as a winning bidder. (*Id.* ¶¶ 98–99.) Menaged allegedly instructed Ms. Nelson and Mr. Dadlani to include on each cashier's check's memo line the words "DenSco Payment [and address of property]" or "DenSco [and address of property]," stamp the back of the check with "Not Used For Intended Purposes," and prepare a withdrawal slip and corresponding deposit slip for the same amount of the checks so that Menaged could redeposit the items after he photographed them. (*Id.* ¶¶ 100–01, 103–04.) DenSco alleges that Ms. Nelson or Mr. Dadlani would prepare this packet before Menaged arrived at the branch. (*Id.* ¶¶ 105, 107.)

Notably, there are no allegations that the Chase Defendants were aware of or privy to the contractual agreements and communications between Menaged and DenSco regarding their business relationship. In fact, there is no allegation that the Chase Defendants were aware of the nature of any relationship between DenSco and Menaged/AZHF, let alone the specific terms of any arrangement between DenSco and AZHF.

DenSco acknowledges and does not dispute that Menaged misrepresented information to the Chase Defendants when Menaged directed transactions. (*Id.* ¶¶ 110–11.) DenSco alleges that upon receiving the completed cashier's checks, Menaged would take photos of them and electronically send them to DenSco to make DenSco believe he was using the loan proceeds to purchase properties. (*Id*.) DenSco alleges that after Menaged sent the photo to DenSco, he would redeposit the cashier's checks back into Menaged's AZHF account, whereupon Menaged would proceed to use the funds in different ways, including, from time to time, withdrawing redeposited funds in cash or transferring the funds to his other Chase accounts. (*Id.* ¶¶ 115, 117, 136.)

DenSco then alleges in conclusory fashion that, given Menaged's banking habits,

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the Chase Defendants knew that Menaged was defrauding DenSco and substantially assisted Menaged. (*See generally id.* ¶¶ 118–36, 137–66.) Absent, however, from the Complaint is any factual allegation that the Chase Defendants had ***express*** knowledge that Menaged or AZHF was dishonest or that the Chase Defendants knew that Menaged's redeposited funds were not being used for the eventual purchase of properties or other proper reasons during the time that AZHF conducted the cashier's check transactions between April 2014 and June 2015.[3] DenSco effectively makes only "should have known" type allegations, and nowhere alleges actual knowledge of Menaged/AZHF's fraud on DenSco.

In addition, the only "financial motive" that DenSco alleges the Chase Defendants to have possessed was that Menaged moved "millions of dollars through his accounts." (*Id.* ¶ 162.) Nowhere does DenSco allege that the Chase Defendants had any sort of economic motivation to assist Menaged in his fraud, let alone an extraordinary reason to do so.

LEGAL STANDARD

The affirmative defense of statute of limitations is properly raised in a motion to dismiss where it appears from the face of the complaint that the claim is barred. *Dicenso v. Bryant Air Conditioning Co.*, 131 Ariz. 605, 606, 643 P.2d 701, 703 (1982). In such case, "the burden is on the plaintiff to establish that the statute has been tolled." *Bailey v. Superior Ct. In and For Pima Cnty.*, 143 Ariz. 494, 498, 694 P.2d 324, 328 (App. 1985); *see also Salcido v. JPMorgan Chase Bank NA*, No. CV-14-02560-PHX-DHG, 2015 WL 1242799, at *5 (D. Ariz. Mar. 18, 2015) (construing Arizona law to require that "[p]laintiffs bear the burden of establishing that a limitations period should be equitably tolled").

A complaint is also properly dismissed when it fails to allege the elements of a claim. In determining if a complaint states a claim, mere conclusory statements are never

[3] This is in stark contrast to DenSco's admitted knowledge of AZHF's fraud in January 2014.

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sufficient. *Cullen*, 218 Ariz. at 419 ¶ 6, 189 P.3d at 346. Moreover, while courts will assume the truth of well-pled factual allegations and indulge all reasonable inferences from those facts, Arizona courts "'do not accept as true allegations consisting of conclusions of law, inferences or deductions that are not necessarily implied by well-pled facts, unreasonable inferences or unsupported conclusions from such facts, or legal conclusions alleged as facts.'" *Sw. Non-Profit Hous. Corp. v. Nowak*, 234 Ariz. 387, 391 ¶ 10, 322 P.3d 204, 208 (App. 2014) (quoting *Jeter v. Mayo Clinic Ariz.,* 211 Ariz. 386, 389 ¶ 4, 121 P.3d 1256, 1259 (App. 2005)). Plaintiffs can also plead themselves out of court when "'the pleadings establish facts compelling a decision one way[.]'" *Solar Utils. Network v. Navopache Elec. Coop., Inc.*, No. CV-12-08095-PCT-PGR, 2013 WL 5434578, at *2 (D. Ariz. Sep. 27, 2013) (quoting *Weisbuch v. Cty. of L.A.*, 119 F.3d 778, 783 n.1 (9th Cir. 1997)).

Finally, for claims alleging fraud, it is not enough to satisfy mere notice pleading standards. Rather, each of the elements of aiding and abetting must meet the heightened pleading standard of Ariz. R. Civ. P. 9(b). *See Van Weelden v. Hillcrest Bank*, No. 2:10-CV-01833, 2011 WL 772522, at *6 (D. Ariz. Feb. 28, 2011) ("Plaintiffs' claim that Defendant aided and abetted [] fraudulent misrepresentation introduces the heightened pleading standard of Rule 9(b)").[4]

ARGUMENT

I. DenSco's Complaint Is Time-Barred on Its Face.

DenSco's Complaint is time-barred because it was filed more than four years after the statute of limitations expired. In Arizona, the statute of limitations for a claim of aiding and abetting fraud is three years, which is the same period applicable to a fraud claim. *Serrano v. Serrano*, No. 1 CA-CV 10-0649, 2012 WL 75639, at *3 (App. Jan. 10, 2012) (citing Ariz. Rev. Stat. § 12-543(3)); *see also Montano v. Browning,* 202 Ariz. 544, 546

[4] Federal cases applying the Federal Rules of Civil Procedure are entitled to "great weight," "[b]ecause Arizona has substantially adopted the Federal Rules of Civil Procedure." *Anserv Ins. Serv., Inc. v. Albrecht,* 192 Ariz. 48, 49 ¶ 5, 960 P.2d 1159, 1160 (Ariz. 1998) (en banc).

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¶ 4, 48 P.3d 494, 496 (App. 2002) ("claims that are clearly brought outside the relevant limitations period are conclusively barred"); *Seven Arts Filmed Enter. Ltd. v. Content Media Corp. PLC,* 733 F.3d 1251, 1254 (9th Cir. 2013) ("A statute-of-limitations defense, if apparent from the face of the complaint, may properly be raised in a motion to dismiss") (internal citation and quotations omitted).

Here, DenSco admits that Menaged engaged in cashier's check transactions at Chase "from April of 2014 through June 2015." (Compl., ¶¶ 133, 161.) Accepting these allegations as true, DenSco has pled itself out of court, having filed this Complaint on August 16, 2019. Because DenSco filed the Complaint more than three years after the last transaction was alleged to have occurred with Chase in June 2015, DenSco's Complaint is time-barred. *See Cornelis v. B & J Smith Assocs. LLC*, No. CV-13-00645-PHX-BSB, 2014 WL 1828891, at *5 (D. Ariz. May 8, 2014) (dismissing fraud-based claims as untimely because they were brought "well after the expiration of the three-year statute of limitations" based on the face of the complaint); *see also Shupe v. Cricket Commc'ns, Inc.*, No. CV 13-1052-TUC-JAS(EJM), 2014 WL 6983245, at *7 (D. Ariz. Dec. 10, 2014) (dismissing fraud claim where it was untimely based on the face of the complaint).

II. DenSco's Complaint Is Fundamentally Flawed Because It Fails to Plausibly Allege Any of the Elements of an Aiding and Abetting Claim.

To state a claim for aiding and abetting, DenSco must plead three elements: (a) Menaged committed a tort that caused injury to DenSco; (b) the Chase Defendants knew Menaged's conduct constituted a tort; and (c) the Chase Defendants substantially assisted Menaged in the achievement of the tort. *Stern v. Charles Schwab & Co., Inc.*, No. CV-09-1229-PHX-DGC, 2010 WL 1250732, at *8 (D. Ariz. Mar. 24, 2010) ("*Stern II*") (citing *Wells Fargo Bank v. Ariz. Laborers, Teamsters, & Cement Masons Local No. 395 Pension Tr. Fund*, 201 Ariz. 474, 485 ¶ 34, 38 P.3d 12, 23 (2002)). Here, DenSco does not and cannot plausibly allege any of these elements. Among other things: (a) DenSco has judicially admitted that there is no actionable underlying fraud claim to support the aiding and abetting claim against the Chase Defendants; (b) DenSco does not

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adequately allege that the Chase Defendants knew of Menaged/AZHF's alleged fraud; and (c) DenSco fails to allege the substantial assistance prerequisite that the Chase Defendants had an extraordinary economic motivation to assist Menaged in the commission of his alleged fraud. Each of these failures independently warrants dismissal of Count Two.

a. DenSco Has Judicially Admitted that There Is No Actionable Underlying Tort Supporting the Aiding and Abetting Claim,

An aiding and abetting claim requires the commission of an underlying tort. *Ariz. Laborers*, 201 Ariz. at 485 ¶ 34, 38 P.3d at 23. Here, that underlying tort is fraud, an "essential element" of which "is actual, justifiable reliance on the alleged misrepresentation." *In re Gorilla Cos., LLC*, 454 B.R. 115, 118 (Bankr. D. Ariz. 2011) (citing *Kuehn v. Stanley,* 208 Ariz. 124, 91 P.3d 346, 350 (Ariz. 2004)). As a matter of law, a party cannot reasonably or justifiably rely on a representation it knows, or has reason to know, to be false. *See In re Kirsh,* 973 F.2d 1454, 1458–60 (9th Cir. 1992) (holding that sophisticated creditor had not justifiably relied on the debtor's representations because there was no excuse for relying on the debtor rather than obtaining a title report); *see also* W. Prosser, *Law of Torts* § 108, p. 718 (4th ed. 1971) ("where [] the facts should be apparent to one of [the victim's] knowledge and intelligence from a cursory glance, or he has discovered something which should serve as a warning that he is being deceived[,] he is required to make an investigation of his own").

DenSco's own pleadings confirm that DenSco cannot state a primary fraud claim against Menaged relating to the alleged cashier's check scheme Menaged perpetrated while banking at Chase from April 2014 through June 2015. DenSco expressly admitted in its complaint against Clark Hill that in January 2014—three months before Menaged allegedly began banking with Chase—DenSco was aware that Menaged and AZHF had fraudulently obtained from DenSco as many as 125 loans and didn't use them to buy properties as promised (i.e., the properties were not secured by a first-position deed of trust.) (*See* Ex. 1, ¶ 3.) DenSco further admitted that—despite knowing of Menaged's

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fraud—DenSco made "2,712 new loans to Menaged" in 2014 and 2015 (the period in which Menaged allegedly banked with Chase). (*Id.* ¶ 8.) DenSco, therefore, concedes that it had express knowledge that Menaged and AZHF squandered DenSco's loan funds through fraud before AZHF opened a single account at Chase. But DenSco chose to continue doing business with Menaged/AZHF, well aware that Menaged/AZHF had already deceived and stolen from DenSco, and unjustifiably relied on Menaged's alleged representations that—this time around—AZHF would really use the DenSco loan funds to buy properties.

These binding admissions preclude DenSco from plausibly pleading justified reliance and an actionable underlying fraud claim, which are necessary for DenSco to plead a secondary aiding and abetting fraud claim against the Chase Defendants. Based on DenSco's knowledge of AZHF's fraud and DenSco's decision to continue doing business with a man and a company it knew to be engaged in fraud (but unbeknownst to others, including the Chase Defendants), DenSco is precluded from attempting to spin a different version of what occurred in this Complaint. Armed with this knowledge, DenSco cannot claim "justifiable reliance" on Menaged's alleged post-January 2014 misrepresentations as a matter of law.

It has long been the law in Arizona "that a party is not entitled to a verdict [on a fraud] if by an ordinary degree of caution the party complaining could have ascertained the falsity of the representations complained of." *Stanley Fruit Co. v. Ellery*, 42 Ariz. 74, 78, 22 P.2d 672, 674 (Ariz. 1933). Here, DenSco's own binding judicial admissions confirm that DenSco failed to exercise even an ordinary degree of caution when it continued doing business with Menaged and AZHF. Given DenSco's business acumen and the relationship between DenSco and Menaged/AZHF, DenSco could not, as a matter of law, justifiably rely on the representations allegedly made. *See AGA Shareholders, LLC v. CSK Auto, Inc.,* 589 F. Supp. 2d 1175, 1191–92 (D. Ariz. 2008) ("aiding and abetting [is a] derivative tort[ ] for which a plaintiff may recover only if it has adequately pled an independent primary tort"). As a matter of Arizona law, DenSco

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not only "had reason to know," but indeed fulsomely admits that it knew that AZHF was engaged in fraud.

This flaw in DenSco's pleading is unfixable, facially demonstrating that DenSco has no actionable aiding and abetting claim against the Chase Defendants as a matter of law. Therefore, Count Two should be dismissed with prejudice.

b. DenSco Also Fails to Plausibly Allege that Chase Knew of Menaged's Alleged Fraud.

In addition to being time-barred on its face and unviable due to the absence of an underlying tort, DenSco's Complaint fails to plead the other necessary elements of an aiding and abetting claim. "The Arizona Supreme Court has stated that 'aiding and abetting liability is based on proof of scienter[;] the defendant must *know* that the conduct they are aiding and abetting is a tort.'" *Stern II*, 2010 WL 1250732, at *8 (quoting *Ariz. Laborers*, 201 Ariz. at 485 ¶ 33, 38 P.3d at 23). "[M]ere knowledge of suspicious activity is not enough. The defendant must be aware of the fraud." *Id.* at *8 (internal citations and quotation marks omitted). "[S]pecifically," the defendants must have been "*aware* that [the fraudster] *did or would in fact*" perpetrate the specific fraud. *Dawson v. Withycombe*, 216 Ariz. 84, 103 ¶ 52, 163 P.3d 1034, 1053 (App. 2007).[5]

Nineteen paragraphs of the Complaint purportedly allege that the Chase Defendants had knowledge of Menaged's fraud on DenSco. (*See* Compl., ¶¶ 118–36.) But none of DenSco's assertions plausibly allege actual knowledge as required under the *Arizona Laborers* standard. Rather, the most that DenSco's allegations suggest is that the Chase Defendants observed Menaged carryout certain banking transactions in a different or unusual way, not that Menaged was involved in a Ponzi scheme predating Chase.

[5] The actual knowledge requirement is of critical importance. The bad actors in Ponzi schemes are the Ponzi principals themselves who bilk investors out of their funds, not banks. That a bank was utilized by a Ponzi schemer should not subject that bank to fraud liability where the bank was not in on the fraud itself. Indeed, banks have long been shielded from liability where a party suffers a loss at the hands of a bank customer. If the "actual knowledge" requirement gets watered down, courts risk putting banks in the costly, pervasive, and untenable position of defending themselves in civil actions predicated on customer misconduct, even where the banks have engaged in no misconduct whatsoever.

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Allegations that a defendant "should have known" of the alleged fraud are not enough. *See Minotto v. Van Cott*, No. 1 CA-CV 15-0159, 2016 WL 3030129, at *4 (App. May 26, 2016) (dismissing aiding and abetting claim where allegations that defendant "*should* have known" did not plead "a level of knowledge sufficient to satisfy the elements of aiding and abetting tortious conduct"); *see also Neilson v. Union Bank of Cal., N.A.*, 290 F. Supp. 2d 1101, 1119–20 (C.D. Cal. 2003) (allegation that defendant bank "should have known" of fraud does not satisfy actual knowledge requirement of aiding abetting claim).[6] Here, at most, DenSco's allegations suggest that the Chase Defendants "should have known" that Menaged/AZHF were duping DenSco because Menaged redeposited cashier's checks into the AZHF account. But DenSco's allegations do not "suggest[] in any way that [Chase] had knowledge of [Menaged's] intent or even propensity to act in bad faith toward [DenSco]." *Federico v. Maric*, 224 Ariz. 34, 37 ¶ 11, 226 P.3d 403, 406 (App. 2010). DenSco cannot make out a proper actual knowledge allegation or aiding and abetting claim by pointing to what the Chase Defendants purportedly should have known.

Similarly, it is well settled that a bank's observance of alleged "red flags" is not sufficient to plead actual knowledge of the specific fraud allegedly at issue. Recognizing this point, Arizona courts hold that even in cases where alleged abettors are aware of a fraudster's "dishonest character, [] poor judgment, and risky business practices"—none of which is alleged here— that does not amount to actual knowledge of their particular fraud, such that aiding and abetting liability does not exist. *Dawson*, 216 Ariz. at 103 ¶ 52, 163 P.3d at 1053. Indeed, "good reason to be suspicious" and facts that "raise[] 'red flags' that should have prompted greater inquiry" are insufficient to "satisfy the knowledge requirement of Arizona's aiding and abetting law." *Stern II*, 2010 WL 1250732, at *10.

[6] In addition, the Arizona District Court has already rejected the contention that banks must "approve, supervise and control [the fraudster's] account," because "[u]nder Arizona case law, the relationship between a bank and an ordinary customer is no more than that of debtor and creditor" and "does not give rise to a fiduciary duty." *Stern II*, 2010 WL 1250732, at *2 (internal quotation marks omitted).

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Simply put, DenSco cannot satisfy its burden to plead actual knowledge by alleging that Chase missed or ignored supposed "red flags" or should have known Menaged was involved in fraud. Here, even DenSco's allegation that the Chase Defendants knew Menaged was redepositing and redistributing funds that DenSco provided to him does not demonstrate actual knowledge of an alleged fraud on DenSco. Pointedly, the Complaint fails to allege that the Chase Defendants knew that Menaged's redeposited funds were not going to be directed to the purchase of properties Menaged identified on the cashier's checks, or that the redeposited funds would be used for some improper business purpose inconsistent with Menaged's representations to DenSco (none of which the Chase Defendants had knowledge of). And despite the conspicuous absence of any allegation that the Chase Defendants knew Menaged to be deceitful or duplicitous, the Complaint concedes that Menaged made misrepresentations to the Chase Defendants. These allegations flatly contradict DenSco's conclusory claim that the Chase Defendants possessed actual knowledge of Menaged's Ponzi scheme and demonstrate how improper it is for the Receiver to include two misled branch bank employees, Ms. Nelson and Mr. Dadlani, as parties to this suit.[7] Arizona courts are clear: even "a reasonable inference that [the Chase Defendants] knew of unusual, unprecedented, and unexplained levels of activity in [Menaged's] account" is insufficient to establish knowledge of the underlying fraud. *Stern II*, 2010 WL 1250732, at *10.

That the Receiver has alleged so little in the way of actual and express knowledge on the part of the Chase Defendants after the many years that the Receiver has been in place solidifies that this element can never be pled; this failure should result in Count Two's dismissal with prejudice.

c. DenSco Has Not Alleged Substantial Assistance.

For similar reasons, DenSco has not and cannot plead substantial assistance. To

[7] To be sure, with the benefit of hindsight, it is *now* public knowledge that Menaged did not purchase the properties with the redeposited checks. But even during the commission of Menaged's fraud, and as DenSco concedes, "[f]rom time to time, Menaged used a cashier's check for its intended purpose to purchase one of the Identified Properties at a trustee's sale." (Compl., ¶ 127.)

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establish the third element of a claim for aiding and abetting, DenSco must plausibly allege that Chase substantially assisted Menaged in the commission of his fraud. *See Stern v. Charles Schwab & Co., Inc.*, No. CV-09-1229-PHX-DGC, 2009 WL 3352408, at *7 (D. Ariz. Oct. 16, 2009) ("*Stern I*"). "Proof of substantial assistance requires a showing that [the defendant's] conduct was 'a substantial factor in causing the [plaintiff's] harm.'" *Id.* at * 8 (quoting *In re Am. Cont'l Corp.*, 794 F. Supp. 1424, 1434–35 (D. Ariz. 1992)). "Processing day-to-day transactions does not constitute substantial assistance unless the bank has an '***extraordinary*** economic motivation to aid in the fraud.'" *Stern I*, 2009 WL 3352408, at *8 (quoting *Ariz. Laborers*, 201 Ariz. at 489 ¶ 48, 38 P.3d at 27) (emphasis added). Arizona courts have made clear that a plaintiff must allege more than the existence of "ordinary account fees and credit interest." *Stern I*, 2009 WL 3352408, at *8 (citing *Ariz. Laborers*, 38 P.3d at 27).

DenSco fails to allege the existence of anything beyond the typical depositor-bank relationship in connection with the AZHF accounts at Chase. Indeed, all that DenSco musters on this point is the vague and conclusory assertion that the Chase Defendants had a "financial motive" to assist Menaged because he moved "millions of dollars through his accounts" at Chase. (Compl., ¶ 162). This nonsensical allegation is plainly insufficient to establish the "extraordinary motivation" required under Arizona law. As the Arizona District Court explained in *Stern I* when rejecting such improper and inadequate pleading: allowing a customer "to open and continue maintaining" an account, "permitting transactions in the millions of dollars, and accepting deposits and transferring money" are simply not enough to plead substantial assistance. *Stern I*, 2009 WL 3352408, at *8–9 (dismissing claim for aiding and abetting because banking services "were not provided in a setting of extraordinary economic motivation"); *see also Neilson*, 290 F. Supp. 2d at 1122 ("ordinary fees, even fees calculated on the basis of the amount of assets held in an account, do not satisfy the 'personal gain or financial advantage' requirement"). Thus, Count Two should be dismissed with prejudice.

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CONCLUSION

For the foregoing reasons, Count Two's sole claim asserted against Chase should be dismissed with prejudice and Chase should be dismissed as a party from this action.

RESPECTFULLY SUBMITTED this 5th day of February, 2020.

GREENBERG TRAURIG, LLP

By: */s/ Nicole M. Goodwin*
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ORIGINAL of the foregoing e-filed with the Clerk of Court this 5th day of February, 2020.

COPY of the foregoing electronically distributed this 5th day of February, 2020 to:

Hon. Daniel Martin

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EXHIBIT 1

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IN THE SUPERIOR COURT OF THE STATE OF ARIZONA

IN AND FOR THE COUNTY OF MARICOPA

Peter S. Davis, as Receiver of DenSco Investment Corporation, an Arizona corporation, Plaintiff, v. Clark Hill PLC, a Michigan limited liability company; David G. Beauchamp and Jane Doe Beauchamp, husband and wife, Defendants.	No. CV 2017-013832 **COMPLAINT** (Eligible for Commercial Court)

For his Complaint against Defendants Clark Hill PLC, David G. Beauchamp, and Jane Doe Beauchamp, Plaintiff Peter S. Davis, as the court-appointed receiver of DenSco Investment Corporation ("Plaintiff" or "Receiver"), alleges as follows.

SUMMARY OF PLAINTIFF'S CLAIMS

1. From July 2001 to July 2016, DenSco Investment Corporation ("DenSco") raised approximately $85 million from investors. DenSco's investors were told *(i)* DenSco would use that money to make short-term "hard money" loans to "foreclosure specialists" who were buying foreclosed homes; *(ii)* the loans would

always be "secured through first position trust deeds," so that DenSco would, in the event a borrower defaulted, recover the loaned funds by taking possession of the property; and *(iii)* DenSco would reduce risk "by attempting to ensure that one borrower will not comprise more than 10 to 15 percent of the total portfolio."

2. During that fifteen-year period, DenSco relied on attorney David G. Beauchamp ("Beauchamp") and the law firms with which he was affiliated for legal advice.

3. In January 2014, Beauchamp and his law firm, Clark Hill PLC ("Clark Hill"), learned that the promises DenSco had made to its investors were untrue and that DenSco's sole owner, shareholder, and operator, Denny Chittick ("Chittick"), had grossly mismanaged DenSco. They were told that two companies controlled by DenSco's single largest borrower, Yomotov "Scott" Menaged ("Menaged"), had fraudulently obtained from DenSco as many as 125 loans that were not secured by a first-position deed of trust. They also learned that Menaged and his companies accounted for 25% or more of DenSco's total loan portfolio.

4. Clark Hill and Beauchamp were told that Chittick and Menaged had agreed that DenSco would refrain from enforcing its current loan agreements with Menaged and his companies, and would instead loan millions more to them, without DenSco first investigating how the fraud had occurred, where DenSco's money had gone, and the impact of the fraud on DenSco's financial position. They were also told that Chittick planned to have DenSco raise new money from investors to fund efforts to help Menaged "fix" the problem before disclosing to those investors the fraud, its effect on DenSco, and the agreement Chittick and Menaged had made.

5. Clark Hill and Beauchamp were in a position to protect DenSco and its investors from further harm. They should have advised DenSco to immediately cease taking any new investor funds, investigate the circumstances of the fraud, assess the Company's options upon the completion of that investigation, and solicit new investor

funds if, and only if, the solicitation was in DenSco's interests and adequate disclosures were made. They did not.

6. If Clark Hill and Beauchamp had properly advised DenSco, an investigation would have revealed that Menaged was a con man who had made up a story about his "cousin" having committed the fraud. The investigation would have also revealed that DenSco was insolvent as a result of Menaged's fraud. DenSco and its investors would have been best served if DenSco had severed its relationship with Menaged and taken all available steps to recover its losses from Menaged.

7. Clark Hill and Beauchamp instead breached fiduciary duties owed DenSco and helped Chittick breach fiduciary duties he owed the Company. Knowing that Chittick had not conducted any investigation of Menaged's "cousin" story, Clark Hill and Beauchamp blessed and helped implement a "work out" agreement with Menaged under which DenSco loaned millions more to the con man. They told Chittick that DenSco could raise new money from investors to fund additional loans to Menaged without first investigating the circumstances of the fraud, assessing its impact on DenSco's financial position, and making disclosures to those investors.

8. Chittick, aided and abetted by Clark Hill and Beauchamp, breached his fiduciary duties to DenSco and its investors by causing DenSco to: *(i)* make 2,712 new loans to Menaged over the next two years for which DenSco has suffered losses in excess of $25 million; *(ii)* obtain more than $15 million from investors who were never told of Chittick's mismanagement of DenSco, Menaged's fraud, and the "work out" agreement; and *(iii)* misdirect investors' money to fund the "work out," rather than use the money as promised to investors when they invested.

9. After Chittick committed suicide in July 2016, Clark Hill and Beauchamp ran the day-to-day operations of DenSco for a period of time. Despite Chittick's death, Clark Hill and Beauchamp sought to conceal from the Receiver, DenSco's investors, and others the fraud Menaged had committed before January 2014, their role in Chittick's two-year attempt to cover up his mismanagement of DenSco that had

allowed the fraud to occur, and Chittick's misuse, with their assistance, of investor funds after January 2014.

10. Plaintiff brings this action to recover compensatory damages for the financial losses DenSco suffered as a result of Clark Hill's and Beauchamp's negligence, breaches of fiduciary duty, and aiding and abetting Chittick's breaches of fiduciary duty, as well as punitive damages. He also seeks an order requiring Clark Hill to disgorge or forfeit all legal fees it charged DenSco while breaching fiduciary duties owed DenSco.

PARTIES, JURISDICTION, AND VENUE

11. Plaintiff was appointed as DenSco's Receiver in *Arizona Corporation Commission v. DenSco Investment Corporation, an Arizona Corporation*, Maricopa County Superior Court, Case No. CV2016-014142 (the "Receivership Court"). He has obtained approval from the Receivership Court to pursue this action.

12. Defendant Clark Hill is a law firm, organized as a Michigan limited liability company, which maintains offices in Scottsdale, Arizona, among other places.

13. Defendant Beauchamp is a lawyer and a member of Clark Hill; he joined the firm in September 2013.

14. Clark Hill and Beauchamp had an attorney-client relationship with, and provided legal services to, DenSco between September 2013 and September 2016.

15. Beauchamp is an Arizona resident who is married to Defendant Jane Doe Beauchamp. Beauchamp was acting for the benefit of his marital community during the relevant time period.

16. This Court has subject matter jurisdiction under Article VI, § 14 of the Arizona Constitution and A.R.S. § 12-123. It has personal jurisdiction over Defendants Clark Hill and Beauchamp because they provided professional services in Arizona to an Arizona corporation.

17. Venue is proper in Maricopa County under A.R.S. § 12-401 because Defendant Clark Hill does business in Maricopa County and Defendant Beauchamp is a resident of Maricopa County.

FACTUAL ALLEGATIONS

18. DenSco is an Arizona corporation that began operating in April 2001. DenSco's primary business was making short-term, high-interest loans to "foreclosure specialists" who bought homes that were being foreclosed upon, usually through a trustee's sale. DenSco's office was in Chandler, Arizona.

19. Chittick was DenSco's sole shareholder. He was the Company's only Director, served as its President, Vice President, Treasurer, and Secretary, and was its only employee.

20. Beauchamp began representing DenSco in 2002 or 2003.

21. From 2003 until September 2016, Beauchamp advised DenSco on general business, litigation, securities law, and other legal matters.

22. In 2007, while he was a partner of Gammage & Burnham, PLLC, Beauchamp participated in the preparation of, and advised DenSco regarding, the loan documents that DenSco used in making loans to "foreclosure specialists" and other borrowers. Those documents included a Mortgage, Note Secured by Deed of Trust, and Deed of Trust and Assignment of Rents. The Mortgage was intended to serve as evidence that DenSco had paid directly to a trustee the proceeds of a loan a borrower had obtained from DenSco to buy property from the trustee at a trustee's sale. Because there was often a delay in a trustee recording a trustee's deed after a trustee's sale, DenSco recorded its Mortgage immediately after a trustee's sale had been completed to establish its lien rights. Once a trustee's deed was recorded, DenSco would record its Deed of Trust and Assignment of Rents. Beauchamp advised DenSco in 2007 and thereafter that these documents and procedures would ensure that DenSco had a first lien position on its loans.

23. Beauchamp also prepared private offering memoranda that DenSco used to raise money from investors. Beauchamp did so in 2003, 2005, 2007, 2009, and 2011.

24. DenSco had fewer than 125 investors, who either had a personal relationship with Chittick or had been referred to him by someone who did.

25. As the private offering memoranda Beauchamp prepared stated, DenSco offered its investors "General Obligation Notes" that were "secured by a general pledge of all assets owned by or later acquired by [DenSco]," with DenSco's largest asset being "the real estate deeds of trust ('Trust Deeds')" that secured the loans DenSco was making to "foreclosure specialists" and others.

26. Given the importance of the Trust Deeds to DenSco's investors, the private offering memoranda Beauchamp prepared told investors that *(i)* "[a]ll real estate loans funded by [DenSco] have been and are intended to be secured through first position trust deeds"; *(ii)* Chittick, whom investors knew and trusted, "would "analyz[e], negotiat[e], originat[e], purchas[e] and servic[e] Trust Deeds by himself"; and *(iii)* DenSco would "strive to achieve a diverse borrower base by attempting to ensure that one borrower will not comprise more than 10 to 15 percent of the total portfolio."

27. Each private offering memorandum issued by DenSco also contained a "prior performance" section which summarized DenSco's "history in raising money from investors, the number of loans made, the aggregate amount of such loans, the underlying values of the security for such loans and any problems with respect to such loans." The section concluded with a representation such as the one made in the July 1, 2011 private offering memorandum (the "2011 POM"): "Since inception through June 30, 2011, the Company has participated in 2622 loans, . . . Each and every Noteholder has been paid the interest and principle (sic) due to that Noteholder in accordance with the respective terms of the Noteholder's Notes. Despite any losses incurred by the Company from its borrowers, no Noteholder has sustained any diminished return or loss on their investment in a Note from the Company."

28. The Notes DenSco sold to its investors were in specified amounts (between $50,000 and $1 million) and paid varying rates of interest, depending on their term. In the 2011 POM, for example, DenSco offered to pay 8% interest on a six-month note, 10% on a one-year note, and 12% on a note of between two and five years.

29. As Beauchamp told a Gammage & Burnham lawyer in 2007, DenSco had an "ongoing roll-over of the existing investors every six months or so," with DenSco offering to issue new Notes to investors as previous Notes expired.

30. Beauchamp knew that DenSco's investors received monthly statements, which depicted the Notes as stable, secure investments. The statements showed the date of an investor's initial purchase of a Note(s), the current maturity date(s), the monthly payment of interest, a monthly balance with accrued interest, and a recap of the amount of interest received in the current year and previous years on Notes that had been "rolled over."

31. Beauchamp advised DenSco that it was appropriate for DenSco to use private offering memoranda that were designed to remain in effect for two years. The 2011 POM, for example, said that DenSco "intends to offer the Notes for placement on a continuing basis until the earlier of (a) the sale of the maximum offering," which was $50 million, "or (b) two years from the date of this memorandum," i.e., until July 1, 2013. That memorandum, and previous memoranda, acknowledged DenSco's ongoing disclosure obligations under the securities laws, stating that "[i]n order to continue offering the Notes during this period, [DenSco] will need to update this Memorandum from time to time." But Beauchamp never advised DenSco to update a private offering memorandum during the two-year period a memorandum was in effect, and no memorandum was ever amended to disclose new material facts or to correct any information no longer current or true.

32. The 2011 POM was the last private offering memorandum DenSco issued.

33. Chittick distributed the 2011 POM to DenSco's investors through a July 19, 2011 email (copied to Beauchamp) which stated, in part, "I update this memorandum every two years. I work with David Beauchamp (securities attorney) to review all the statues [sic] and laws in Arizona as it pertains to my business and all the states that I have investors in. This is to ensure that I'm filing all the forms and following all the rules . . ."

34. In June 2013, Beauchamp was a partner of Bryan Cave LLP.

35. Through a June 10, 2013 email, Beauchamp told Bryan Cave lawyers that DenSco "is a client which makes high interest loans (18% with no other fees) secured by first lien position against real estate. . . . DenSco has previously had aggregate investor loans outstanding at approximately $16 to $18 million from its investors. We are starting the process to update and renew DenSco's private offering memo (renew it every two years) and we have now been advised that DenSco now has almost $47 million in aggregate investor loans outstanding."

36. Although Bryan Cave had an "internal compliance procedure" requiring Beauchamp to conduct "due diligence" on each of the statements made in the new DenSco private offering memorandum he was preparing, Beauchamp did not do so.

37. Beauchamp did not seek to determine whether the representation in the draft memorandum, that "[t]he Company continues to strive to achieve a diverse borrower base by attempting to ensure that one borrower will not comprise more than 10 to 15 percent of the total portfolio," was accurate. Had he done so, Beauchamp would have learned that as of July 1, 2013, approximately 30% of DenSco's loan portfolio consisted of loans made to Menaged or companies he controlled.

38. Beauchamp knew, from his discussions with Chittick and the text of the draft private offering memorandum he was preparing, that DenSco continued to represent to investors that its loans were in first position. The draft memorandum, like the 2011 POM, stated that "[a]ll real estate loans funded by the Company have been and are intended to be secured through first position trust deeds." Beauchamp also

reviewed DenSco's website on June 17, 2013. The website stated, under a "Lending Guidelines" heading: "First Position ONLY!"

39. Yet Beauchamp failed to perform any due diligence to determine whether DenSco's loans were, in fact, in first position. Had he done so, Beauchamp would have learned that as of July 1, 2013 $6.48 million, or approximately 40% of the approximately $16.2 million of loans DenSco had made to Menaged and his companies as of that date, were not in first position.

40. Not only did Beauchamp fail to conduct due diligence on DenSco's loan portfolio, he ignored evidence of deficiencies in DenSco's lending practices when it was handed to him. On June 14, 2013, Chittick sent Beauchamp by email a copy of a complaint that had been filed in Arizona Superior Court by Freo Arizona, LLC. The defendants were DenSco; one of Menaged's companies, Easy Investments, LLC; and another "hard money" lender, Active Funding Group, LLC.

41. According to the complaint, Freo had acquired a foreclosed home at a trustee's sale and filed its lawsuit to establish that it owned the property free and clear of liens asserted by DenSco and Active Funding Group. The complaint and other documents Beauchamp received identified by street address and legal description the home at issue; they also identified the names of the former owners.

42. Chittick's transmittal email described Menaged, the owner of Easy Investments, as a borrower that DenSco had "done a ton of business with, million[s] in loans and hundreds of loans." He said that DenSco would "piggy back with [Menaged's] attorney to fight" the lawsuit but wanted Beauchamp to be aware of the litigation, and asked that he contact Menaged's attorney.

43. The complaint put Beauchamp on notice that DenSco was not in first position on at least one of its loans. It expressly alleged that Easy Investments had "attempted to encumber the property with deeds of trust to Active [Funding Group] and DenSco," which put Beauchamp on notice that Menaged, one of DenSco's major

borrowers, had obtained loans from both DenSco and another "hard money" lender, each intended to be secured by the same property.

44. Beauchamp did nothing to investigate these facts and whether they were indicative of a broader breakdown in DenSco's underwriting practices.

45. If Beauchamp had sought to review records available through the Maricopa County Recorder's website relating to the property described in the Freo lawsuit, he would have found: *(i)* a Deed of Trust and Security Agreement With Assignment of Rents given by Easy Investments in favor of Active Funding Group, that Menaged had signed on March 25, 2013; and *(ii)* a Deed of Trust and Assignment of Rents given by Easy Investments in favor of DenSco, that Menaged had signed on April 2, 2013. Both signatures were witnessed by a notary public.

46. Beauchamp did not complete an updated private offering memorandum for DenSco before July 1, 2013, when the 2011 POM expired.

47. Beauchamp knew at the time, as he told another Bryan Cave attorney, that DenSco had "approximately 60 investor notes that are scheduled to expire in the next 6 months." Because DenSco had not updated the 2011 POM and did not issue a new private offering memorandum in July 2013, Beauchamp knew that DenSco would be accepting those "roll over" investments, and was likely to accept money from new investors, without providing those investors with an up-to-date offering memorandum.

48. Through a letter dated August 30, 2013, DenSco was advised that Beauchamp would be leaving Bryan Cave effective August 31, 2013 to join Clark Hill.

49. When Beauchamp moved his law practice to Clark Hill, DenSco retained Clark Hill and became a client of the firm.

50. DenSco's retention of Clark Hill was confirmed through a letter dated September 12, 2013. The letter stated that DenSco had engaged Clark Hill to represent it "with regard to the legal matters transferred to Clark Hill PLC from Bryan Cave LLP." Through an email exchange that day, Beauchamp and Chittick identified the

transferred matters to include "general corporate" and files relating to the 2011 POM and the new private offering memorandum Beauchamp had begun preparing in 2013.

51. Clark Hill's engagement letter made clear that Clark Hill viewed DenSco as its client, and had not agreed to also represent Chittick.

52. At DenSco's request, Beauchamp opened a "new matter" in Clark Hill's accounting and filing systems on September 13, 2013 for work the firm would perform in advising DenSco on securities law matters, including the preparation of a new private offering memorandum.

53. Clark Hill and Beauchamp did not begin work on a new private offering memorandum during the remaining months of 2013.

54. On Monday, January 6, 2014, Clark Hill and Beauchamp learned that as many as 52 loans DenSco had made to two of Menaged's companies – Easy Investments (one of the defendants in the Freo lawsuit Chittick had sent Beauchamp in June 2013) and Arizona Home Foreclosures – were not "secured through first position trust deeds," as stated in the 2011 POM, and as DenSco had claimed as recently as June 17, 2013 on its website. They acquired that information through a demand letter DenSco had received earlier that day from a law firm representing two companies that had also made loans to Easy Investments and Arizona Home Foreclosures, and a third company which had been assigned such loans, all of which were identified in the letter as the "Lenders." Chittick promptly sent the letter to Beauchamp.

55. The demand letter identified, with reference to specific loan numbers and street addresses, 52 loans that the Lenders had made to Easy Investments and Arizona Home Foreclosures to acquire foreclosed homes at trustee sales. The letter asserted that the Lenders' loans had been made by "certified funds delivered directly to the trustee" and secured by "promptly recorded deeds of trust confirming a senior lien position on each of the Properties."

56. The demand letter went on to assert that DenSco had "engaged in a practice of recording a 'mortgage' on each of the [52 properties] on around the same

time as the Lenders were recording their senior deeds of trust" and that each such mortgage falsely stated that DenSco had "provided purchase money funding" and that its "loans are 'evidenced by a check payable' to the trustee for each of the Properties." The letter asserted that DenSco could not claim to be in a senior lien position on those properties "since in each and every instance, only the Lenders provided the applicable trustee with certified funds supporting the Borrower's purchase money acquisition for each of the Properties."

57. The letter demanded that DenSco sign subordination agreements acknowledging that it did not have a first position lien on any of the 52 properties, and said that if DenSco refused to do so, the companies would assert claims against DenSco for fraud and conspiracy to defraud; negligent misrepresentation; and wrongful recordation pursuant to A.R.S. § 33-420.

58. It should have been obvious to Beauchamp, in light of the allegations in the Freo lawsuit he had received the previous June and the claims made in the demand letter, that Easy Investments and Arizona Home Foreclosures had purposefully obtained, for each of the 52 properties, a loan from one of the Lenders, and had then obtained a second loan from DenSco that was supposed to be secured by the same property.

59. Beauchamp spoke to Chittick by telephone on January 6, 2014. Beauchamp's notes from that call state that Chittick told him DenSco's "largest borrower" – Menaged – "had a guy working in his office and was getting 2 loans on each property," and that Chittick and Menaged "had already fixed about 6 loans." The notes reflect that Beauchamp planned to meet with Chittick on Thursday, January 9, 2014.

60. Clark Hill and Beauchamp recognized, or should have recognized, that the claims made in the demand letter affected a material portion of DenSco's loan portfolio. They knew from the 2011 POM that DenSco's average loan amount was $116,000, so that DenSco's potential exposure for the 52 under-secured or unsecured

loans was likely to be approximately $6 million or more, or approximately 13% of the $47 million that Beauchamp understood DenSco had raised from investors as of June 2013.

61. On January 7, 2014, Beauchamp received an email from Chittick, copied to Menaged, which contained information relevant to the demand letter and said that Chittick was bringing Menaged to the planned January 9 meeting.

62. Chittick's email said that DenSco had, since 2007, loaned $50 million to "a few different LLC's" controlled by Menaged. Among those limited liability companies were Easy Investments and Arizona Home Foreclosures.

63. Chittick's email said that "[b]ecause of our long term relationship, when [Menaged] needed money, [I] would wire the money to his account and he would pay the trustee," Menaged would sign a Mortgage that referenced the payment to the trustee, and Chittick would cause the Mortgage to be recorded.

64. Chittick's statement put Beauchamp on notice that Chittick had failed to comply with the terms of the Mortgage document Beauchamp and Gammage & Burnham had prepared in 2007, which called on DenSco to make payments directly to a trustee, and that Chittick had allowed the fraud committed by Easy Investments and Arizona Home Foreclosures to have occurred, by not paying loan proceeds directly to a trustee, and instead wiring funds directly to Menaged.

65. Chittick's email went on to say that Menaged had told him in November 2013 that DenSco had been defrauded by Menaged's "cousin," who allegedly worked with Menaged in managing Easy Investments and Arizona Home Foreclosures. Menaged claimed that his "cousin" had "receiv[ed] the funds from [DenSco], then request[ed] them from . . . other lenders [who] cut a cashiers check for the agreed upon loan amount . . . [took] it to the trustee and . . . then record[ed] a [deed of trust] immediately." Chittick explained that "sometimes" DenSco had recorded its mortgage before another lender's deed of trust was recorded, but in other cases it had not. According to Chittick, "[t]he cousin absconded with the funds."

66. It should have been obvious to Beauchamp, in light of the allegations in the Freo lawsuit he had received the previous June and the claims made in the demand letter, that Menaged's story about his "cousin" having perpetrated the fraud could be called into doubt. Chittick's acceptance of the story, without conducting an independent investigation, should have concerned Beauchamp.

67. Chittick's email said "I know that [I] can't sign the subordination [agreement] because that goes against everything that [I] tell [DenSco's] investors."

68. Chittick concluded his email by telling Beauchamp that he and Menaged had agreed upon a "plan to fix this," which included DenSco loaning additional monies to Menaged, and a joint effort by DenSco and Menaged to raise funds to pay off the senior liens on the double-encumbered properties.

69. Beauchamp met with Chittick and Menaged on Thursday, January 9, 2014.

70. Beauchamp learned in the January 9, 2014 meeting that there were lenders in addition to the three companies identified in the January 6, 2014 demand letter who held liens senior to DenSco's liens. According to Beauchamp's notes from that meeting, the number of loans made by DenSco that were not in first position and were either under-secured or unsecured was between 100 and 125. Based on that information and the 2011 POM's average loan amount of $116,000, Beauchamp knew that DenSco had potentially lost between $11.6 and $14.5 million, representing between 25% and 30% of the $47 million that Beauchamp understood DenSco had raised as of June 2013. If Beauchamp had pressed Chittick for details during that meeting, he would have learned that, as of November 2013, when Chittick first learned of the fraud, 186 loans, with a value of approximately $25 million – more than 40% of DenSco's total loan portfolio – were either under-secured or unsecured.

71. The information Beauchamp learned in the January 9, 2014 meeting confirmed what was evident from the January 6, 2014 demand letter – that DenSco did not have the diverse loan portfolio promised to investors in the 2011 POM, and had,

under Chittick's management, loaned at least 25% of its portfolio to Menaged and his companies. If Beauchamp had pressed Chittick for details during that meeting, he would have learned that, as of January 1, 2014, more than 45% of DenSco's loan portfolio were loans to Menaged and his companies.

72. Beauchamp's notes from the January 9, 2014 meeting also reflect that he, Chittick, and Menaged discussed how to implement Chittick's and Menaged's plan to jointly raise funds to pay off the senior lenders on the double-encumbered properties within a ninety-day period.

73. Based on the information Beauchamp received from Chittick before and during the January 9, 2014 meeting, Clark Hill and Beauchamp should have promptly advised Chittick that:

a. DenSco had to immediately cease accepting investor funds and could not accept any money from investors on the basis of an out-of-date offering memorandum they now knew contained material misrepresentations and omitted material information;

b. before deciding whether additional investment should be solicited, DenSco had to first investigate the circumstances under which the Menaged entities had obtained loans from both DenSco and the lenders who claimed to have senior liens;

c. before deciding whether additional investment should be solicited, DenSco had to also investigate and assess the impact of the fraud on DenSco's financial position; if the fraud had rendered DenSco insolvent or in the zone of insolvency, then DenSco had to consider duties owed to its investors and other creditors in making business decisions; and

d. if, after conducting those investigations and assessments, DenSco decided that it was in DenSco's interest to loan additional monies to Menaged and his companies, refrain from enforcing its rights and remedies against them, and raise investor funds in the process, DenSco could only do so utilizing an

offering memorandum or other disclosure document that made appropriate disclosures to investors.

74. Clark Hill and Beauchamp failed to do so.

75. Clark Hill and Beauchamp did not promptly advise Chittick that DenSco had to immediately cease accepting investor funds and could not accept any money from investors until a new disclosure document had been issued and provided to such investors. Clark Hill and Beauchamp did not advise Chittick of the potential civil and criminal liability he and DenSco faced if DenSco accepted investor funds without such disclosure.

76. To the contrary, after Beauchamp and Chittick spoke by telephone on January 10, 2014, Chittick wrote that Beauchamp told him "I can raise money."

77. Beauchamp's advice was also documented in an email exchange he had with Chittick two days later, on January 12, 2014. Chittick said "if both Scott and [I] can raise enough money, we should be able to have this all done in 30 days easy." He told Beauchamp that he had "spent the day contacting every investor that has told me they want to give me more money," and thought he could have $5 to $6 million within the next ten business days. Rather than tell Chittick that DenSco must immediately cease accepting or soliciting any investor money, and warn Chittick of his and DenSco's potential civil and criminal liability if DenSco did so, Beauchamp gave his approval of Chittick's plan, and told Chittick he "should feel very honored that you could raise that amount of money that quickly."

78. Clark Hill and Beauchamp did not promptly advise Chittick that before deciding whether additional investment should be solicited, DenSco had to first investigate the circumstances under which the Menaged entities had obtained loans from both DenSco and the lenders who claimed to have senior liens.

79. If an investigation had been conducted, easily accessible public records would have revealed that Menaged's claim to have been victimized by his "cousin" was false, and that Menaged himself had perpetrated a massive fraud on DenSco by taking

advantage of DenSco's lax lending practices and obtaining duplicate loans on more than 100 properties.

80. Clark Hill and Beauchamp did not promptly advise Chittick that before deciding whether additional investment should be solicited, DenSco had to also investigate and assess the impact of the fraud on DenSco's financial position; nor did they further advise DenSco that if the investigation and assessment resulted in a finding that DenSco was insolvent or in the zone of insolvency, DenSco had to consider duties owed to its investors and other creditors in making business decisions.

81. If an investigation and assessment of the fraud's impact had been conducted, DenSco would have determined that the fraud had rendered the Company insolvent.

82. If Clark Hill and Beauchamp had properly advised Chittick, then Chittick would have caused DenSco to terminate its relationship with Menaged and his companies, pursue its remedies against Menaged and his companies, and explore whether DenSco could survive as a going concern or would have to liquidate.

83. Having failed to properly advise DenSco, Clark Hill and Beauchamp then took actions that were not in DenSco's interest, but were instead intended to protect Chittick.

84. They did so even though Chittick was not a client of Clark Hill, and despite the glaring conflict between Chittick's interests and those of Clark Hill's only client, DenSco.

85. On January 10, 2014, Beauchamp opened a "new matter" in Clark Hill's accounting and filing systems captioned "work-out of lien issue."

86. Clark Hill and Beauchamp knew when that file was opened that Chittick intended to breach fiduciary duties owed DenSco by: *(i)* accepting without questioning Menaged's explanation that his "cousin" was responsible for the fraud committed by Easy Investments and Arizona Home Foreclosures; *(ii)* failing to investigate the true facts of the fraud; *(iii)* failing to assess the impact of the fraud on DenSco's financial

position; *(iv)* committing DenSco to loan millions more to Menaged and his companies without conducting such an investigation and assessment; and *(v)* accepting and soliciting funds from investors based on an out-of-date offering memorandum Clark Hill and Beauchamp knew contained material misrepresentations and omitted material information.

87. Clark Hill and Beauchamp went on to negotiate, first with Menaged's lawyer and then with Menaged, a Term Sheet, which was signed on January 17, 2014, a Forbearance Agreement, which was signed by Chittick (for DenSco) and Menaged on or about April 16, 2014, and documents to memorialize additional loans DenSco made to Menaged and his companies.

88. Clark Hill's and Beauchamp's misplaced devotion to Chittick's interests, and disregard of the duties they owed to their only client, DenSco, was evidenced by numerous statements Beauchamp made during the negotiation of the Forbearance Agreement. For example, in a January 21, 2014 email, Beauchamp told Chittick the Forbearance Agreement was needed to "give you protection if any of your investors raise questions."

89. In response to revisions of a draft of the Forbearance Agreement that Menaged's lawyer had made, Beauchamp wrote in a February 7, 2014 email: "Based on your previous changes, the Forbearance Agreement would be prima facia evidence that Denny Chittick had committed securities fraud because the loan documents he had Scott sign did not comply with DenSco's representations to DenSco's investors in its securities offering documents. Unfortunately, this agreement needs to not only protect Scott from having this agreement used as evidence of fraud against him in litigation, the agreement needs to comply with Denny's fiduciary obligation to his investors as well as not become evidence to be used against Denny for securities fraud."

90. Another example of Clark Hill's and Beauchamp's misplaced devotion to Chittick is Beauchamp's February 20, 2014 email to lawyers in Clark Hill's offices in Michigan and Pennsylvania, seeking assistance on the Forbearance Agreement, in

which Beauchamp conflated DenSco and Chittick as the firm's client. Beauchamp wrote: "Our client is an investment fund that has made approximately 185 loans to two affiliated LLCs that are collectively referred to as Borrower. . . . Without any additional documentation or any legal advice, our client has been reworking his loans and deferring interest payments to assist Borrower/Guarantor to pay off some of the duplicate loans. When we became aware of this issue, we advised our client that he needs to have a Forbearance Agreement in place to evidence the forbearance and the additional protections he needs."

91. These and other statements make plain that Clark Hill and Beauchamp were aware that Chittick's conduct violated Chittick's duties to their client, DenSco, and rather than seeking to vindicate DenSco's interest, they helped DenSco's unfaithful agent Chittick cover up his wrongdoing.

92. The Forbearance Agreement included a schedule of the loans DenSco had made to Menaged, members of his family, Easy Investments, and Arizona Home Foreclosures, including loans DenSco made between December 2013 and April 15, 2014. Those loans totaled $37,456,620.47, well over half of the aggregate amounts DenSco had raised from investors.

93. Based on the January 9, 2014 "work out" agreement blessed by Clark Hill and Beauchamp and the terms of the Forbearance Agreement that Clark Hill and Beauchamp negotiated and documented, DenSco made 2,712 loans to Menaged and his companies from January 2014 through June 2016, for which DenSco has suffered losses in excess of $25 million.

94. It was not until after the Forbearance Agreement was signed that Clark Hill and Beauchamp took any steps to prepare an updated and corrected private offering memorandum for DenSco. In mid-May 2014, Clark Hill prepared a preliminary draft of that document. The draft reflected Clark Hill's belief that it represented both DenSco and Chittick, despite the terms of Clark Hill's engagement letter and the unconsentable conflict arising from Chittick's breach of fiduciary duties owed DenSco. The draft

stated, in part, that Clark Hill "represent[ed] the Company and its President." Clark Hill never sent that draft to DenSco and took no further steps to prepare a new private offering memorandum for DenSco's use.

95. DenSco never issued a new private offering memorandum but continued to raise money from investors in return for promissory notes based on the out-of-date 2011 POM, which contained material misrepresentations and omitted material information. DenSco received more than $15 million from investors from January 2014 through June 2016.

96. Chittick committed suicide on July 28, 2016.

97. After Chittick's death, Clark Hill and Beauchamp took over the day-to-day management of DenSco, including communicating with investors, representatives of the Securities Division of the Arizona Corporation Commission, and Plaintiff. In those communications, Clark Hill and Beauchamp did not disclose material information about their knowledge of the fraud committed by Menaged before January 2014; DenSco's lax lending practices and failure to follow its own lending documents which allowed the fraud to occur; the negotiations which resulted in the Forbearance Agreement; their role in its preparation; the continued lending to Menaged and his companies contemplated by that agreement; their knowledge of DenSco's solicitation and receipt of investor funds after January 2014 based on the out-of-date and materially misleading 2011 POM; the misuse of investment proceeds contrary to the representations made to investors; and the general cover up of wrongdoing by Chittick.

CLAIMS FOR RELIEF

Count One
(Legal Malpractice)

98. Paragraphs 1 to 97 are incorporated herein.

99. Clark Hill and Beauchamp were DenSco's lawyers.

100. While representing DenSco, Clark Hill and Beauchamp breached the applicable standard of care.

101. While representing DenSco, Clark Hill and Beauchamp breached fiduciary duties they owed to DenSco.

102. By failing to comply with the standard of care and breaching their fiduciary duties, Clark Hill and Beauchamp caused injury to DenSco.

103. DenSco suffered resulting damage in an amount to be proven at trial. Plaintiff's damages are liquidated. Plaintiff seeks prejudgment interest on the losses suffered by DenSco as a result of certain loans made to Menaged and his companies. Plaintiff also seeks prejudgment interest on all disgorged fees.

Count Two
(Aiding and Abetting Breach of Fiduciary Duties)

104. Paragraphs 1 to 97 are incorporated by reference.

105. As a director and officer of DenSco, Chittick owed fiduciary duties to DenSco.

106. Chittick breached his fiduciary duties to DenSco.

107. Clark Hill and Beauchamp knew that Chittick intended to breach and in fact breached his fiduciary duties to DenSco.

108. Clark Hill and Beauchamp, in breach of fiduciary duties they owed to DenSco, aided and abetted Chittick in his breach of fiduciary duties to DenSco.

109. By reason of Chittick's breach of fiduciary duty, DenSco was injured.

110. DenSco suffered resulting damage in an amount to be proven at trial. Plaintiff's damages are liquidated. Plaintiff seeks prejudgment interest on the losses suffered by DenSco as a result of certain loans made to Menaged and his companies. Plaintiff also seeks prejudgment interest on all disgorged fees.

WHEREFORE, Plaintiff prays:

a. For an award of compensatory damages against Clark Hill and Beauchamp for their negligence, breaches of fiduciary duty, and aiding and abetting Chittick's breaches of fiduciary duty;

b. For an order requiring Clark Hill to disgorge and pay to Plaintiff all attorneys' fees DenSco paid to Clark Hill for work performed on or after January 9, 2014;

c. For an award of punitive damages;

d. For an award of prejudgment interest;

e. For costs incurred herein, pursuant to A.R.S. § 12-341; and

f. For such other relief as may be equitable to the Court.

DATED this 16th day of October, 2017.

OSBORN MALEDON, P.A.

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