



Portfolio Media, Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Deloitte Liable For Mortgage Execs' Fraud, 9th Circ. Told

By **Beth Winegarner**

Law360, San Francisco (March 15, 2013, 6:54 PM ET) -- A Nevada federal court erred when it excused financial advisers Deloitte & Touche LLP from liability for breaching a contract and allowing insiders at USA Commercial Mortgage Co. to steal from the now-bankrupt mortgage company and defraud investors, the company argued Friday, urging the Ninth Circuit to revive the case.

The liquidating trust for USA Commercial — which went bankrupt in 2006 — argued that the misdeeds of mortgage-company CEO Thomas Hantges and President Joseph Milanowski could not be imputed to the company as a whole, as the lower court ruled. Instead, Deloitte and Touche, which performed external audits of the company's financial statements from 1999 to 2001, is responsible because it knew about the pair's misdeeds and didn't tell anyone, according to briefs in the case.

J. Maxwell Beatty, an attorney for USA Commercial's liquidating trust, urged the Ninth Circuit on Friday to overturn the federal court's ruling in favor of Deloitte and Touche's in pari delicto defense, which held that the mortgage company was equally responsible for Hantges and Milanowski's fraud.

"In direct violation of Nevada law, the district court ignored the presence of shareholders who were innocent of any wrongdoing," Beatty said. "Nevada law says that when applying in pari delicto, you should not be so enamored with a Latin phrase that you apply it to all situations of illegality."

Hantges and Milanowski ran USA Commercial from 1997 until its bankruptcy. During that time, the pair "systematically looted the company," but kept their misconduct secret from the firm's other decision-makers, according to court documents.

In one scheme, they used the company's assets to fund separate companies, and in another, they launched a Ponzi scheme using funds from USA Commercial's performing loans to pay the interest on nonperforming loans, the company's briefs said. Milanowski ultimately pled guilty to federal fraud charges and is serving a 12-year sentence, court documents said.

After USA Commercial filed for bankruptcy in 2006, it sued Deloitte and Touche, its former auditor, in 2008, accusing the company of breach of contract and aiding and abetting Hantges and Milanowski, and also seeking to recover damages. Deloitte and Touche's motion for summary judgment in the case was granted in early 2011, based on its in pari delicto defense as well as its argument that the case was barred by statutes of limitations.

But the Nevada federal court was wrong to uphold that defense because USA Commercial's

other decision-makers knew nothing about Hantges and Milanowski's fraud — and would have stopped them if Deloitte's auditors had reported it, USA Commercial's briefs said.

Judge Sandra Segal Ikuta asked Beatty whether case law decided by the Nevada Supreme Court suggested Nevada state law "tips more toward allowing the in pari delicto defense," she said.

"One of the issues is the manner in which the district court looks at it," Beatty answered. The judge "looked at the legal fiction of imputation, rather than the reality. That was the error that was made."

Miles Ruthberg, an attorney representing Deloitte and Touche, argued that there was no reason to reverse the federal court's ruling, and that the Nevada Supreme Court has emphasized a "broad imputation rule, in order to incentivize corporations to supervise their own agents."

Deloitte and Touche argued in its briefs that it can't be liable for Hantges and Milanowski's alleged misdeeds because they took place after the financial advisers bowed out of their relationship with USA Commercial.

Judges J. Clifford Wallace, Sandra Segal Ikuta and Marvin J Garbis sat on the panel for the Ninth Circuit.

USA Commercial Mortgage Liquidating Trust is represented by J. Maxwell Beatty, Allen B. Diamond and Andrea L. Kim of Diamond McCarthy LLP and by Robert Marshall Charles of Lewis and Roca LLP.

Deloitte & Touche is represented by Melanie Blunsch, Robert W. Perrin and Miles N. Ruthberg of Latham & Watkins LLP, and Steve Morris and Rosa Solis-Rainey of Morris Law Group.

The case is USACM Liquidating Trust, et al. v. Deloitte & Touche LLP, case number 11-15626, in the U.S. Court of Appeals for the Ninth Circuit.

--Editing by Jeremy Barker.

All Content © 2003-2013, Portfolio Media, Inc.