UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

MICHAEL MALONE, *et al.*,

Plaintiffs,

v.

CLARK NUBER, P.S., *et al.*,

Defendants.

Case No. C07-2046RSL

ORDER DENYING PLAINTIFFS' MOTION FOR PARTIAL SUMMARY JUDGMENT AND GRANTING DEFENDANTS' MOTIONS FOR SUMMARY JUDGMENT

I. INTRODUCTION

This matter comes before the Court on motions for summary judgment filed by Multi National Strategies, LLC, Coastal Trading LLC, Michael N. Schwartz, and David Schwartz (collectively, the "MNS defendants") and by David Schwartz individually. Plaintiffs filed a cross motion for partial summary judgment regarding their claim under the Washington State Securities Act ("WSSA").

Plaintiffs Michael and Barbara Malone allege that the defendants, who include the MNS defendants and other entities and individuals too numerous to list, designed, promoted, and defrauded them into participating in an abusive tax shelter called the "Coastal Trading Common

Trust Fund Series III" and the "Coastal Trading Common Trust Fund Series IV" (collectively, "CTF"). The Internal Revenue Service ("IRS") ultimately disallowed CTF and imposed penalties and interest on plaintiffs, which they now seek to recover from defendants. Plaintiffs also seek to recover the fees they paid to defendants for professional services that, accordingly to plaintiffs, were performed negligently or not at all. Through other orders and stipulations, plaintiffs' claims against the other defendants have been resolved and only the MNS defendants remain.

At the parties' request, the Court heard oral argument in this matter on August 26, 2010. For the reasons set forth below, the Court denies plaintiffs' motion for partial summary judgment, grants David Schwartz's motion for summary judgment, and grants the MNS defendants' motion for summary judgment.

II. DISCUSSION

A. Background Facts.

The facts relevant to this motion were set forth in the Court's June 23, 2008 order granting in part and denying in part motions to dismiss filed by several defendants (Dkt. #118) and will not be repeated here. Coastal Trading was a company dedicated to creating alternative investment strategies for high net worth individuals such as plaintiffs. Defendant Michael Schwartz was a principle of Coastal Trading and defendant David Schwartz was an employee. Plaintiffs allege that Coastal Trading LLC "designed, implemented, and executed the CTF transaction." Third Amended Complaint at ¶ 222. They further allege that the MNS defendants collected fees in connection with the transaction and issued monthly reports to Malone. Id.

In prior orders, the Court dismissed plaintiffs' federal claims. It also dismissed their state law claims under the Consumer Protection Act and Criminal Profiteering Act and for unjust enrichment and constructive trust. Plaintiffs have remaining claims against the MNS defendants for fraud, negligent misrepresentation, violation of the WSSA, breach of contract/implied duty of good faith and fair dealing, breach of fiduciary duty, aiding and abetting a breach of fiduciary duty, professional negligence, and joint venture conspiracy. This order addresses those remaining claims.

B. Applicability of New York Law.

In the MNS defendants' reply in support of their motion for summary judgment, they argued, for the first time, that based on a contractual choice of law provision, New York law applies and requires the dismissal of most of plaintiffs' claims. The Court issued an order permitting plaintiffs to respond to the new argument, which they have done.

As plaintiffs note, the Court typically will not consider arguments made for the first time in a reply memorandum. See, e.g., Carver v. Gonzales, 2006 U.S. Dist. LEXIS 87020 (W.D. Wash. 2006) ("It is well-established that courts will not consider new arguments raised for the first time in a reply brief.") (citing Lentini v. Cal. Ctr. for the Arts, 370 F.3d 837, 843 n.6 (9th Cir. 2004) (citing cases)). The justification for disregarding the new argument is strong in this case: the MNS defendants waited until the last possible moment to raise the issue. The MNS defendants, collectively, and David Schwartz, individually, filed motions for summary judgment and responded to plaintiffs' motion for summary judgment, all without raising the argument that New York law might apply. Although defendants might argue that the Court has provided plaintiffs an opportunity to address the issue, the Court permitted plaintiffs only ten pages to do so, far less than the 24 pages they were permitted to use in their opposition memoranda. Moreover, this case has been pending for nearly three years, during which time the parties have litigated the case with reference to Washington law and filed numerous motions all relying on Washington law. For those reasons, plaintiffs would be prejudiced and significant resources would be wasted if the Court were to determine, at this late date, that New York law applies. Although defendants argue that the issue was "overlooked" because of plaintiffs' voluminous pleadings, that argument is untenable. Defendants argue that New York law applies based on their own contract, not based on any of plaintiffs' filings. Accordingly, the Court grants plaintiffs' request to strike the portion of defendants' reply memorandum that argues that New

York law applies.

The Court also notes that by failing to raise the issue in a timely manner, defendants have waived the affirmative defense that New York law applies and preempts most of plaintiffs' claims. See, e.g., Pershing Park Villas Homeowners Ass'n v. United Pac. Ins. Co., 219 F.3d 895, 899 (9th Cir. 2000) (explaining that a party waives a challenge to prudential standing, but not constitutional standing, by failing to raise it in a timely manner); see also Schwartz v. Snohomish County, 2006 U.S. Dist. LEXIS 15065 (W.D. Wash. 2006) (explaining that a party may waive an affirmative defense "if either (1) assertion of the defense is inconsistent with the defendant's prior behavior or (2) the defendant has been dilatory in asserting the defense.") (internal citations and quotation omitted); see also Burnside v. Simpson Paper Co., 123 Wn.2d 93 (1994) (explaining that because Washington is the forum state, its law applies unless a party, in a timely manner, invokes foreign law). Defendants did not raise the issue in their answer or any amended answer, or at any time prior to their reply memorandum. For those reasons, defendants have waived the defense. The Court will apply Washington law, as the parties have throughout this litigation.

C. Washington Law: Statute of Limitations.

The MNS defendants argue that all of plaintiffs' claims, except their claim for breach of a written contract, are barred by the applicable statute of limitations. Most of the actions which underlie plaintiffs' claims occurred in 2001. Plaintiffs filed their complaint on September 7, 2007. As set forth in prior orders, all of plaintiffs' remaining state law claims have three-year statutes of limitations except their claim of breach of a written contract, which has a six-year statute of limitations pursuant to RCW 4.16.040. Plaintiffs do not dispute these limitations periods. Nevertheless, plaintiffs argue that their claims are timely because the applicable statutes of limitations are tolled under the doctrine of continuing representation and/or the discovery rule.

1. Continuous Representation/Relationship Doctrine.

Under the doctrine of continuing representation, the statute of limitations for tort and contract claims is tolled during a professional's "representation of the client in the same matter from which the malpractice claim arose." See Burns v. McClinton, 135 Wn. App. 285, 293 (2006). Courts have applied the doctrine to toll claims against attorneys, accountants, physicians, and other fiduciaries. Id.; see also Hermann v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 17 Wn. App. 626 (1977).[1]

Plaintiffs argue that the MNS defendants represented them as late as March 13, 2006 because on that date, David Schwartz signed a final tax return on behalf of Belmar Trading Inc. However, as set forth more fully below regarding Schwartz's motion for summary judgment, he signed the return not as an investment advisor, accountant, fiduciary, or in any similar role to which the continuous relationship doctrine has been applied.[2] Rather, he signed the document as an "officer" and "corporate secretary" of Belmar. The continuous representation/relationship doctrine has never been applied to the actions of a corporation's own officer, and the policy reasons underlying the doctrine do not support such an extension. For that reason alone, plaintiffs' theory fails to toll the statutes of limitations.

Moreover, the returns were actually filed on behalf of Belmar Trading Inc., a separate legal entity. Plaintiffs' Reply at p. 6. Although Belmar is listed as a plaintiff in the complaint, plaintiffs have always defined themselves in this litigation as "Michael and Barbara Malone." Plaintiffs' Motion for Partial Summary Judgment at p. 1. The Malones have failed to show that

[1] Defendants argue that the continuing representation doctrine applies only to claims against attorneys. However, a recent unpublished Court of Appeals case suggested that the doctrine applies more broadly and the continuing relationship rule "has thus survived in the case of resulting trusts only." Vollstedt v. Tegman, 2010 Wn. App. LEXIS 730 at *7 (April 12, 2010).

[2] Although Michael Schwartz had a role in preparing the returns, there is no evidence about when that activity occurred, and plaintiffs have not shown that it occurred during the limitations period. Instead, their argument rests on the allegation that David Schwartz "prepared and signed" the final return in March 2006. Plaintiffs' Reply at p. 6.

the MNS defendants represented *them* during the limitations period, and they cannot assert a claim on behalf of another legal entity.

Even if plaintiffs could overcome those problems, the theory fails. In a prior motion to dismiss, the MNS defendants argued that the continuing representation doctrine was inapplicable, and the Court explained that the third amended complaint had sufficiently *alleged* facts to show that it could apply. Order at pp. 8-9 (Dkt. #203). Now that discovery has been conducted and additional documents submitted, it is clear that the MNS defendants were not plaintiffs' advisors or fiduciaries as alleged. Defendants other than the MNS defendants were plaintiffs' investment advisors. Third Amended Complaint at ¶ 28 (alleging that Clark Nuber was plaintiffs' "investment advisor" who had a "long-standing fiduciary relationship" with plaintiffs). In contrast, the MNS defendants did not occupy a position of trust, nor had they ever represented plaintiffs. Their contractual duties were owed to the trustee, not to plaintiffs. In fact, when it became clear that the IRS was disallowing the investment, plaintiffs hired other professionals to advise them, sometimes in a manner adverse to the MNS defendants. Furthermore, the parties' contract explicitly disclaimed a relationship of trust: the CTF private offering memorandum stated that it was not to be construed as "investment advice." Declaration of Malcolm Harris, (Dkt. #263) ("Harris Decl."), Exs. 14-A and 14-B at p. ii ("Investors are expected to conduct their own inquiries into the program, the trust fund, their structure, investment objectives, business and operations. The contents of this memorandum are not to be construed as legal, tax, or investment advice."). The same documents also provide:

> The program also has been structured to facilitate a tax strategy that each investor has independently decided to pursue by making an investment in the program, that each tax strategy is not discussed in this private offering memorandum, each investor has independently received a complete description of the federal, state and local tax consequences and potential federal, state and local tax risks of an investment in the program from that investor's tax advisor, and anticipates receiving a tax opinion from investor's tax counsel, and will rely exclusively on such advice and opinion with respect to all tax matters relating to an investment in the program. Investors have not received from, nor have investors relied upon, Coastal . . . or any of their affiliates, agents or employees for any tax advice or any tax opinion with respect to an investment in the program.

Id. at p. i. The "Securities Warnings and General Information" section of the CTF memoranda stated that defendants were not authorized to provide investors with any information or to make representations outside the memoranda. Id. at p. ii. The CTF subscription agreements signed by Malone contain similar provisions. Id., Exs. 15-A and 15-B at p. D-2 ("Investor has not received from . . . nor has Investor relied upon, Coastal . . . or any of their affiliates, agents or employees for any tax advice or any tax opinion with respect to an investment in the Program."). Accordingly, the documents themselves disclaim any fiduciary or tax/investment advisor role. Plaintiffs also contend that in February 2005, Michael Schwartz sent Mr. Malone a letter enclosing Belmar's tax forms, stating that he "must report" interest income received and a corresponding interest expense "should be reported." Harris Decl., Ex. 41. Plaintiffs do not argue that the document is actionable; rather, they argue that it shows that the MNS defendants continued to represent them in 2005. Even if the letter were construed as tax advice, it does not reflect an on-going fiduciary or advisor relationship if none existed in the first place. In the absence of such a relationship, the continuing representation doctrine is inapplicable and does not toll the statute of limitations.

2. Discovery Rule.

Plaintiffs also contend that the discovery rule tolls the statutes of limitations. Pursuant to the discovery rule, a cause of action accrues and the statute of limitations begins to run when a plaintiff "discovers, or in the exercise of reasonable diligence should have discovered the facts which give rise to his or her cause of action." Johnson v. Reehoorn, 56 Wn. App. 692, 695 (1990) (internal citation and quotation omitted). A cause of action for fraud accrues when the aggrieved party discovers the facts constituting the fraud. RCW 4.16.080(4).

Plaintiffs rely on a recent Supreme Court decision that held that, for purposes of a claim under SEC Rule 10b-5, "the limitations period does not begin to run until the plaintiff . . . discovers or a reasonably diligent plaintiff would have discovered the facts constituting the violation," including scienter. Merck & Co., Inc. v. Reynolds, __U.S. __, 130 S. Ct. 1784, 1796-

99 (2010). Plaintiffs' Rule 10b-5 claim, however, was dismissed long ago, so the *Merck* decision is inapplicable in this case. Under Washington law, plaintiffs are not required to have notice of all of the relevant facts to trigger the statute of limitations. Instead,

> The general rule in Washington is that when a plaintiff is placed on notice by some appreciable harm occasioned by another's wrongful conduct, the plaintiff must make further diligent inquiry to ascertain the scope of the actual harm. The plaintiff is charged with what a reasonable inquiry would have discovered. One who has notice of facts sufficient to put him upon inquiry is deemed to have notice of all acts which reasonable inquiry would disclose.

Green v. A.P.C., 136 Wn.2d 87, 96 (1998) (internal citations and quotation omitted); see also Hudson v. Condon, 101 Wn. App. 866, 875 (2000) (explaining that the statute of limitations for a fraud claim "commences when the aggrieved party discovers, or should have discovered, the fact of fraud and sustains some damage as a consequence").

In a prior order, the Court explained:

> In August 2003, the IRS issued a notice entitled "Common Trust Fund Straddle Tax Shelter" (the "IRS notice") which stated that "the claimed tax benefits purportedly generated by these transactions are not allowable for federal income tax purposes." Amended Complaint at ¶ 52. That notice specifically disallowed the CTF shelter. Malone was also personally notified of the issue. By letter dated December 22, 2003, CTF President Michael Schwartz advised Malone to file an amended tax return and to retain an attorney. Amended Complaint at ¶ 161; Second Declaration of Michael Malone, (Dkt. #61) ("Second Malone Decl."), Ex. 6 (the "CTF letter"). The CTF letter explained that the IRS notice stated "that the IRS intended to challenge the tax benefits associated with" CTF, the transaction plaintiffs "entered into in 2002." The CTF letter further stated that some of Schwartz's clients were currently under IRS investigation. "This has led me to conclude that the IRS will shortly begin an investigation of my company as well, ultimately requiring me to provide them with a list of all clients that have entered into listed transactions. As such it is almost certain that you will [be] audited at some time in 2004." In addition, contrary to Clark Nuber's assertion that the Sidley Austin opinion letter would preclude penalties, the CTF letter explicitly stated, "The IRS recently has been taking the very aggressive position that tax opinions do not necessarily provide penalty protection on the basis that the taxpayer did not reasonably rely in good faith on the opinion." Malone subsequently retained an attorney.
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> The CTF letter and the IRS notice put plaintiffs on notice of nearly all of the facts that defendants allegedly concealed from them and that give rise to their claims, including the fact that CTF lacked economic substance, that the IRS would not allow the deductions, that the IRS would audit plaintiffs, and that the Sidley Austin letter would not necessarily prevent the imposition of penalties.

Order (Dkt. #118) at pp. 13-14.[3]

After defendants filed motions to dismiss, plaintiffs argued that they suffered damages because the loan underlying the transaction was a sham, which they did not learn until March 2007. The Court granted plaintiffs leave to elaborate on that theory, and the third amended complaint does so. Plaintiffs allege that former defendant HVB agreed to provide a $15.6 million loan to Braxton Management, Inc. (the "loan"), which would in turn loan the funds to Malone, who would invest the funds in a corporation wholly owned by him. Malone apparently planned to invest the funds in two entities controlled by him: Belmar Investment Trust and Belmar Trading, Inc. The funds were to be used to purchase foreign currency options that generated both losses and gains. The losses would be used to offset Malone's capital gains while the gains were allocated to tax-indifferent trusts. Notably, other than asserting that they learned in March 2007 that the loan was a sham, plaintiffs have not identified any other facts learned after the end of 2003 to show that they were unable to file their claims earlier.

Plaintiffs' elaboration of their theory that the loan was a sham shows that the theory is simply a restatement of their claim that CTF lacked economic substance. The sham nature of the loan was one of the reasons why CTF lacked economic substance. Plaintiffs admitted as much in their discovery responses, stating the IRS notice indicated that the loan was a "'sham' loan." Harris Decl., Ex. 61 at p. 11. The third amended complaint also shows that the loan was not a separate transaction, but was a necessary part of the CTF transaction: "the investment program was centered upon a sham loan." Third Amended Complaint at ¶ 34. The third amended

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[3] Plaintiffs' amended complaint alleges some additional facts that further confirm that plaintiffs had notice of the claims in late 2003 and early 2004. The third amended complaint alleges: (1) in November 2003, a U.S. senate subcommittee held hearings regarding abusive tax shelters. Later the same month, Malone withdrew nearly all of his original cash contribution from his CTF account, (Third Amended Complaint at ¶¶ 42-44, Ex. 28); (2) in January 2004, Coastal sent a letter to Malone suggesting that plaintiffs withdraw any cash left in their CTF account if they had not already done so, (id., Ex. 28); (3) in January 2004, Malone sent a letter to Coastal asking it to pay his attorney's fees for contesting IRS penalties related to CTF. Id.

complaint also alleges:

- "[T]he CTF transaction was . . . an abusive tax shelter, consisting of a sham loan totally lacking in economic substance." Id. at ¶ 33.
- The loan documentation was part of the CTF transaction. Id. at ¶ 38.
- The loan was "at the heart of the CTF transaction." Id. at ¶ 41.
- The "investment program sold to Plaintiff was centered around a sham loan that was not a bona fide loan." Id. at ¶ 109.
- Defendants had a duty to disclose "those aspects of the investment program that caused it or might cause it to lack economic substances, such as the sham nature of the loan at the center of the transaction." Id. at ¶ 110.

As plaintiffs' own allegations show, the sham nature of the loan caused it to lack economic substance. Therefore, because plaintiffs knew by the end of 2003 that CTF lacked economic substance, it could have discovered by that time that the loan was a sham.

Furthermore, all of the elements underlying plaintiffs' causes of action had occurred by the end of 2003. The MNS defendants had made the alleged misrepresentations and omissions. Plaintiffs knew that CTF lacked economic substance, that the MNS defendants had not advised them of that fact despite an alleged duty to do so, and that they had incurred some damages. They could have brought their claims at that time. See, e.g., Hudson, 101 Wn. App. at 876 (dismissing fraud claims as time barred; explaining that the statute of limitations began to run when plaintiffs could have brought their claims). The fact that plaintiffs incurred additional damages after that time is irrelevant to the statute of limitations inquiry. Id. at 875 ("The running of the statute is not postponed by the fact that the substantial damages occur later, and is not postponed until the specific damages occur for which the plaintiff seeks recovery").

Even if plaintiffs did not know all of the relevant facts by the end of 2003, they were under a duty to investigate at that time. See, e.g., Green, 136 Wn.2d at 96. The *Gevaart* case is instructive. Gevaart v. Metco Constr., Inc., 111 Wn.2d 499, 502 (1988). In *Gevaart*, the plaintiff was injured when she fell off a sloped stair. She sued the construction company for negligence more than three years after her injury occurred. She contended that even though she knew at the time she was injured that the stair was sloped, she did not learn until later that the stair did not conform to the building code. The Washington Supreme Court refused to toll the statute of limitations until the date when plaintiff discovered the building code violation because plaintiff "knew the stair sloped [and] by the exercise of due diligence she could have determined that the step did not conform to the building code and further, the true reason why the slope existed." Id. (explaining that plaintiff's claims were time barred). Similarly, in this case, the statute of limitations is not tolled until plaintiffs learned *all* of the reasons why the transaction lacked economic substance. Rather, if they had exercised due diligence in 2003 when they learned that the transaction lacked economic substance, they could have learned that the loan allegedly was a sham.

Therefore, the discovery rule does not toll the statute of limitations. All of plaintiffs' claims against the MNS defendants, except their claim for breach of a written contract, are time barred.

D. Claims Against David Schwartz: Tax Preparer Liability.

In addition to being time barred, defendants argue that plaintiffs' claims against defendant David Schwartz fail on the merits because his role was merely clerical and ministerial. Declaration of David Schwartz, (Dkt. #254) ("D. Schwartz Decl.") at ¶¶ 3-4; Declaration of Michael Schwartz, (Dkt. #262) ("M. Schwartz Decl.") at ¶¶ 4, 5. David Schwartz never acted as plaintiffs' investment advisor. D. Schwartz Decl. at ¶ 7. Rather than rebutting that evidence, plaintiffs have asserted a new claim against David Schwartz: they allege that he is liable as plaintiffs' tax preparer. The Internal Revenue Code provides for penalties against a "tax return preparer" who understates a taxpayer's liability, including taking an unreasonable position on a tax shelter in a return "unless it is reasonable to believe that the position would more likely than not be sustained on the merits." I.R.C. § 6694(a)(2)(C). The Code defines a tax return preparer as "any person who prepares for compensation" a tax return, with certain exceptions. I.R.C. § 7701(a)(36).

Plaintiffs note that David Schwartz signed three Form 1120S forms, “US Income Tax Return for S Corporation” for Belmar Trading Inc. for the tax years 2002, 2003, and 2004. Although the applicable IRC provision provides for penalties, plaintiffs have not shown that it supplies a private right of action. Even if it did, plaintiffs have failed to provide any evidence that David Schwartz prepared the relevant returns as a tax preparer for compensation. Instead, as they admit, he signed the returns in his role as an officer of Belmar Trading Inc. Declaration of Brian Isaacson, (Dkt. #278) (“Isaacson Decl.”), Ex. C at CNMA018022. In the “title” section next to his signature, he wrote, “Corporate Secretary.” Id. Consistent with acting in that role, he added that the form had been “self prepared” and did not sign the section titled, “Paid Preparer’s Use Only.” Id. In fact, Schwartz signed the forms as an officer of the company with the express written consent of Mr. Malone, who was the sole director of Belmar Trading, Inc. D. Schwartz Decl. at ¶ 14, Ex. 7 (“Unanimous Written Consent of the Sole Director of Belmar Trading Inc.”); Declaration of David Schwartz in Support of His Reply (Dkt. #285) at ¶ 4. Therefore, plaintiffs’ claim that Schwartz prepared the returns for compensation is unsupported and in fact, contradicted by the record.

Plaintiffs argue in the alternative that David Schwartz’s motion should be continued to allow them to take Mr. Schwartz’s deposition. They state that the discovery is necessary to “expose the extent of Schwartz’s liability and role in the CTF.” Opposition to D. Schwartz’s Motion for Summary Judgment at p. 6. Plaintiffs should have had that basic information before they filed the complaint, or at least obtained it since filing the case. Although they note that the parties recently agreed to continue the discovery deadline, that does not explain why plaintiffs failed to conduct the deposition sooner. Certainly, they could have done so. Furthermore, plaintiffs have not identified what, specifically, they hope to learn or how the information will defeat summary judgment. Plaintiffs’ dilatory conduct and vague hope that discovery might uncover additional information are insufficient to delay a ruling on the motion for summary judgment. See, e.g., Garret v. City & County of San Francisco, 818 F.2d 1515, 1518 (9th Cir.

1987) (explaining that a party opposing the dispositive motion "must make clear what information is sought and how it would preclude summary judgment."). The Court will therefore grant David Schwartz's motion for summary judgment.

E. Claim for Breach of Written Contract and Request for a Continuance.

As alleged in the complaint, plaintiffs' breach of contract claim comprised several different theories. Plaintiffs alleged that all defendants entered into written contracts with them "to provide Plaintiffs with professionally competent investment advice, legal services, accounting services and financial services," to exercise applicable standards of care, and comply with their legal and professional obligations. Third Amended Complaint at ¶ 389. That claim relies on duties implied under defendants' professional obligations, simply restates a professional negligence claim, and is time barred for the reasons set forth above. Plaintiffs also alleged that defendants "promised performance they knew or should have known they could not deliver." Id. at ¶ 393. That vague allegation, however, is untethered to a promise of any specific result, and the contracts are devoid of any such provisions. Plaintiffs appear to have abandoned those claims, and all other breach of contract claims, except one based on the following theory: plaintiffs contend that the MNS defendants breached the terms of the CTF Private Offering Memorandum ("POM") by falsely promising that the transaction would include a loan, when in fact the loan was a sham. Third Amended Complaint at ¶¶ 226-28, 390. That contention has two parts. First, plaintiffs contend that defendants misrepresented their ability to provide legitimate insurance for the loan. Plaintiffs' Opposition at p. 11. The undisputed evidence, however, shows that although the MNS defendants drafted paperwork regarding the insurance, plaintiffs never completed their portion of the paperwork to finalize the insurance. M. Schwartz Decl. at ¶ 19. Instead, they converted the loan to a non-recourse loan. In light of that unrebutted evidence, plaintiffs' claim on that theory fails.

Second, plaintiffs contend that HVB[4] never actually issued the loan, in violation of defendants' promise that a loan would be issued. In support of that claim, plaintiffs contend that "Schwartz admitted that he believed the risk of loss on the CTF loan was virtually zero." Plaintiffs' Opposition at p. 6 (emphasis omitted). That statement, however, is neither an admission nor circumstantial evidence that the loan was a sham. Rather, as Michael Schwartz stated in his declaration, he agreed to provide insurance on the loan because he believed the loan was not risky. M. Schwartz Decl. at ¶ 18 ("I believe that Plaintiffs' ability to claim tax benefits generated from their CTF investment on their joint federal income tax returns would not have been disallowed by the IRS had they obtained such insurance."). Schwartz's statement that he did not believe the borrowers were at risk of defaulting on the loan is not the same as stating, as plaintiffs allege, that the loan itself would not be made.

Plaintiffs also argue that HVB has stated, in a Statement of Admitted Facts in connection with a deferred prosecution agreement in another forum, that it made loans that were not bona fide. Isaacson Decl., Ex. A (Declaration of Tarifa Laddon). Specifically, HVB stated,

> [B]etween 1996 and 2002 HVB participated in a number of fraudulent tax shelter transactions devised by others, including a series of transactions known as "Bond Linked Issue Premium Structure" ("BLIPS"), "Custom Adjustable Rate Debt Structure" ("CARDS"), "common trust fund," and "357(c)" transactions. HVB's activities in connection with these and other transactions included: (i) participating in transactions purporting to be loans that were not bona fide loans . . . .

Id. Laddon submitted her declaration and the Statement of Admitted Facts before this Court when HVB was a defendant in this matter, so it is properly authenticated. The Court takes judicial notice of the document because it was filed in another forum. Plaintiffs' loan was purported to be issued in 2001, within the time frame in the statement. However, although plaintiffs argue that the statement means "all of the loans" made during the six-year time period

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[4] This Court dismissed the action against the HVB entities for lack of personal jurisdiction and improper venue. Plaintiffs subsequently filed suit against those entities in the U.S. District Court for the Southern District of New York, which subsequently dismissed the claims as time barred.

were shams, the statement does not say that. Nor does the document mention the MNS defendants, plaintiffs, the transaction at issue in this case, or the programs involved in this case: the Coastal Trading Common Trust Fund Series III and Coastal Trading Common Trust Fund Series IV. Although the document provides additional detail regarding the BLIPS program and other transactions, it does not do so regarding the CTF transactions. Plaintiffs attempt to bolster their argument with a report from their purported expert, Calvin Johnson, who opines, "In 2006 HvB entered into a deferred prosecution agreement agreeing to pay a fine of $29 million and accepting and admitting that it had participated in 'fraudulent and unlawful' shelters including 23 common trust fund shelters like the one sold to the Malones." Isaacson Decl., Ex. B. That opinion, however, even it were accepted, does not state that the Malones' loan was a sham, nor would it have a basis for doing so. In contrast, defendants have filed a declaration from the Treasurer and Vice President of HVB-Finance who states, in a declaration submitted under penalty of perjury, that the loan was made: "Pursuant to the loan agreement dated December 3, 2001, HVB-Finance made a loan to Braxton Management, Inc. ("Braxton"), a New Jersey based company." Harris Decl., Ex. 56 (Declaration of John Gallagher at ¶ 5) (explaining that the loan was made and serviced in New York); <u>see also</u> M. Schwartz Decl. at ¶ 15 (explaining that the loan was a "bona fide loan that was outstanding at the time of Plaintiffs' participation in the CTF transaction. The loan started with HVB-NY and ended with . . . HVB-SF.").

Plaintiffs argue that they may rely on circumstantial evidence, *i.e.*, the deferred prosecution agreement, to defeat summary judgment, but as set forth above, that agreement is unpersuasive regarding the Malones' loan. Furthermore, this is not a case where reliance on such evidence is required. Because the loan proceeds were to come to Malone, albeit indirectly, for him to invest in the Belmar entities, he should have known whether the loan ever actually funded. Plaintiffs do not allege that they never received the loan proceeds. Nor is there any evidence that they ever complained to defendants about not receiving those proceeds. To the contrary, Mr. Malone explicitly represented that he received the loan proceeds as contemplated.

In a letter to Sidley Austin Brown & Wood LLP, Malone stated that pursuant to the program, he "borrowed $15,600,000 cash from Braxton Inc. ("Loan"). . . . Investor then lent the proceeds of the Loan to Investments on the same terms to Investments."[5] Harris Decl., Ex. 19 at pp. 6-7.

There is also no need to rely on unsupported inferences based on the deferred prosecution agreement because whether or not the loan was made should be documented. Plaintiffs could have obtained evidence regarding whether the loan was made, but they have not done so. Instead, they now request a continuance to conduct discovery. However, they have not diligently pursued opportunities to take discovery since this case was filed. They have not taken any depositions in this case. They issued a subpoena to HVB in January 2010, long after this case was filed, and never issued a properly narrowed subpoena after the district court in the Southern District of New York quashed the subpoena as overly broad and unduly burdensome, which it certainly was. Although plaintiffs note that the discovery deadline has been extended in this case, the real issue is whether plaintiffs have diligently pursued discovery, and they have not. In addition, plaintiffs have never specified what they hope to obtain from a continuance. The failure to do so, combined with their overbroad requests to HVB, demonstrate that they are seeking to fish for helpful documents. Accordingly, their request for a continuance is denied, and their breach of contract claim fails as unsupported.

III. CONCLUSION

For all of the foregoing reasons, the Court DENIES plaintiffs' motion for partial summary judgment (Dkt. #249), GRANTS David Schwartz's motion for summary judgment (Dkt. #253), and GRANTS the MNS defendants' motion for summary judgment (Dkt. #261). The Clerk of

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[5] During oral argument, plaintiffs' counsel contended that the letter is the result of the law firm putting words in plaintiffs' mouths. There is no evidence to support that allegation.

the Court is directed to enter judgment in favor of defendants and against plaintiffs.

DATED this 30th day of August, 2010.

Robert S. Lasnik
United States District Judge