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Counsel for the Rev Op Group

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re: MORTGAGES LTD., Debtor.	In Proceedings Under Chapter 11 Case No. 2:08-bk-07465-RJH **MOTION TO RECONSIDER AMENDED MEMORANDUM DECISION AND ORDER** Hearing Date: Not Yet Set Hearing Time: Not Yet Set

Pursuant to this Motion, the Rev Op Group requests entry of an order reconsidering the Court's Memorandum Decision dated October 21, 2009 (as amended, the "**Memorandum Decision**"), and the related Order entered by the Court. [DE #2323, 2345] Pursuant to the Memorandum Decision, the Court issued its ruling on the Rev Op Group's motion for entry of order clarifying the chapter 11 plan dated March 12, 2009 (the **"Plan"**), and this Court's order confirming the Plan dated May 20, 2009 (the "**Confirmation Order"**). This Motion is further supported by the declaration of Louis B. Murphey, which has been contemporaneously filed herewith and is incorporated herein in its entirety. In support of this Motion, the Rev Op Group submits as follows:

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INTRODUCTION

1. On September 14, 2009, the Rev Op Group filed its motion for clarification with the Court (the "**Clarification Motion**").[1] [DE #2168] Various parties filed joinders and objected to the Clarification Motion.

2. The ML Manager is dominated and controlled by non-Pass-Through Investors. *See* L. Murphey Declaration, ¶25; Confirmation Order, ¶G; Plan, ¶4.12. Not surprisingly, the ML Manager filed an extensive objection to the Clarification Motion (the "**ML Objection**"). [DE #2265]

3. After the Clarification Motion was filed with the Court, the ML Manager's counsel uploaded an Order to the Court setting October 16, 2009 as the new deadline for Pass-Through Investors to transfer their fractional interests in ML Notes, which deadline was later changed at the request of the ML Manager to October 31, 2009. This Order set a *non-evidentiary* hearing on the Clarification Motion for October 8, 2009. [DE #2197]

4. The Court held a *non-evidentiary* hearing on October 8, 2009. The Court entered its Memorandum Decision on October 22, 2009. On the same day the Court issued its decision, the ML Manager filed an emergency motion asking the Court to essentially change its ruling that the ML Manager did not have the "power to sell" the ML Notes without the consent of Non-Transferring Investors (the "**Supplemental Motion**"). [DE #2327]

5. Presumably because the ML Manager represented to the Court that the Supplemental Motion presented a true emergency that needed to be addressed before the October 31 deadline, the Court ruled on the Supplemental Motion without conducting a hearing. The Court granted the ML Manager's Supplemental Motion pursuant to its Order dated October 28, 2009 (the "**Supplemental Order**"). [DE #2338]

[1] Unless otherwise defined herein, all capitalized terms in this Motion will have the meaning ascribed to such terms in the Clarification Motion.

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6. Based on the ML Manager's representations in the Supplemental Motion, the Court made a significant change to the original Memorandum Decision in the Supplemental Order. The Court essentially "ruled by omission" that the ML Manager has the power to sell the ML Notes of Non-Transferring Investors to the extent provided by the "governing documents."[2]

7. The Rev Op Group has filed this Motion seeking relief pursuant to Rule 59 and Rule 60 of the Federal Rules of Civil Procedure with respect to the original Memorandum Decision and the Supplemental Order. *See also* Fed. R. Bankr. Proc. 9023, 9024.

THE "POWER TO SELL" AND RELATED AUTHORITY ISSUES

8. The ML Manager has traveled *way over the line* as a fiduciary on the "power to sell" issue and its repeated representation to the Court that all Non-Transferring Investors are bound to a blank form agency agreement. In the Supplemental Motion, the ML Manager coyly characterizes this issue as merely "one internal inconsistency or potential inconsistency" in the Memorandum Decision. This one issue has massive ramifications for all Pass-Through Investors.

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[2] The original Memorandum Decision was clear that the ML Manager could neither sell nor encumber the Non-Transferring Investors' interests in the ML Notes, but otherwise had the power to "deal with the loans and collateral securing the loans to the extent provided by the governing documents . . ." As discussed more fully below, the ML Manager knew at the time it filed its Supplemental Motion that at least two Rev Op Group members – Louis B. Murphey and Lonnie Krueger – had specifically limited the Debtor's ability to act on their behalf. Despite this knowledge, the ML Manager asked the Court to delete the word "sell" from its Memorandum Decision so that, by omitting this word, the Court's ruling suggests that the ML Manager now has the power to sell the ML Notes of Non-Transferring Investors. The Rev Op Group believes this attempt by the ML Manager to bend the facts is doomed to failure in any event since its authority is limited – in the words of the Court – "to the extent provided in the governing documents." It is still important, however, for the Court to amend its ruling, especially because it is based on the ML Manager's factual representations which are disputed, incomplete, and inaccurate.

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9. In the Clarification Motion, the Rev Op Group stated the decision-making and control issues as one succinct question: "[W]hether the ML Manager LLC or the Non-Transferring Investor has the right to make key decisions about the Notes . . ." Clarification Motion, ¶6, p.3. In the ML Objection, the ML Manager accused the Rev Op Group of not really wanting a clarification on these issues; the ML Manager argued, "instead, they don't like the answers and seek to change the answers." ML Objection, p.8. This accusation is false. *See* L. Murphey Declaration, ¶¶1-5.

10. According to the ML Manager, the answer to the succinct question is as follows: "The answer is clear under the Agency Agreement that under the Agency Agreement . . . *the Agent has "sole discretion" to make the decisions.* There is no voting or consent mechanism in the Agency Agreement." ML Objection, p.9 (emphasis added).

11. The Plan went effective in June of 2009. The ML Manager has been in control of the books and records of the Debtor since then and, obviously, has had access to the *actual contracts* between the Debtor and all Pass-Through Investors for many months. Rather than present the *actual contracts* between the Debtor and Rev Op Group, however, the ML Manager deliberately used the language in a *blank form agency agreement* in support of its arguments.

12. On this basis, the ML Manager represented to the Court that the answer the Rev Op Group did not like – but was allegedly binding on them – is that the ML Manager possessed sole decision-making authority through language in a blank form agency agreement. The ML Manager's failure to rely upon the actual contracts is significant for a number of reasons, including the fact that *one month* before the ML Manager filed its objection, the Rev Op Group filed with the Court and delivered to the ML Manager's counsel all of the contracts that the Rev Op Group believed were relevant to the Clarification Motion.

13. The Rev Op Group's contracts were filed and delivered on September 25, 2009. [DE #2219] So the ML Manager was given actual contracts a month beforehand

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and still decided to press forward with an argument based on a blank form agency agreement.

14. Indeed, the ML Manager continued to press forward with this very same argument as late as last week, when it filed the Supplemental Motion and attached thereto yet another copy of the blank form agency agreement. In that Supplemental Motion, the ML Manager told the Court it needed to change its initial ruling on the Memorandum Decision regarding the "power of sale" issue because Section 1(d) of this unsigned document "clearly provides the Agent, which is now the ML Manager, can 'liquidate' or sell a fractionalized interest in a loan when the Participant does not own 100% of the Notes." Supplemental Motion, p.3.

15. The ML Manager waited until *after* the Court issued its initial ruling to provide the Rev Op Group with the actual contracts in the possession of the ML Manager. Certain of these contracts, previously undisclosed by the ML Manager are highly relevant if not totally dispositive on key issues of authority and control relative to certain members of the Rev Op Group.

16. So after weeks of waiting, the Rev Op Group finally received all of the various contracts that the ML Manager contends it holds, as assignee of the Debtor, against the members of the Rev Op Group. While it took weeks to produce these documents and they were only produced upon repeated threat of the filing of a Rule 2004 application, the ML Manager finally delivered *500 pages* of contracts and other related documents to counsel for the Rev Op Group.[3]

[3] *See* Email from R. Miller to C. Reece dated October 21, 2009, a true and correct copy of which is attached hereto as Exhibit A. To be clear, the Rev Op Group had previously filed with the Court what they believed were the actual contracts that existed between the Debtor and the Rev Op Group members. [DE #2219] Counsel for the ML Manager, however, told the Rev Op Group these were not the correct contracts, so the Rev Op Group has been waiting for the ML Manager to provide the contracts it contends are binding on the Rev Op Group.

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17. Specifically, on October 26, 2009, the ML Manager's counsel delivered these contracts and other related documents, along with a cover letter that is fairly described as a "litigation position letter," to counsel for the Rev Op Group. *See* L. Murphey Declaration, Ex. A. What is obvious from these documents is that the ML Manager has known for weeks, if not months, that at least one of the Rev Op Group members – Mr. Murphey – specifically refused to give the Debtor a "power of attorney" *and* specifically refused to give the Debtor discretion to make decisions on his behalf. *See* L. Murphey Declaration, ¶¶10-12.[4]

18. Simply stated, the ML Manager's contention that all Non-Transferring Investors are bound to a blank form of agency agreement where the Debtor had the unfettered right to make all decisions for such investors – except for the small exception of encumbering their note interests – is refuted by its very own documents.

19. As if this was not bad enough, the ML Manager filed the Supplemental Motion even though it had in its possession a letter to Mr. Murphey signed by Mr. Scott Coles, as President and CEO of the Debtor, where Mr. Coles openly acknowledged the Debtor did not have the power to act without the affirmative consent of Mr. Murphey. In March of 2008, Mr. Coles wrote:

> [W]e have enclosed a newly revised Investor Subscription Agreement for each of your accounts. *To protect your investment, we need the ability to act in your best interest . . . As servicing agent we need your discretion to modify loan documents or enter into agreements with borrowers. It is extremely important for you to give us the discretion to act in your best interest . . . Please authorize or grant discretion wherever asked as we truly believe this is in our best interests*."

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[4] Mr. Murphey is not the only member of the Rev Op Group who refused to surrender full decision-making authority to the Debtor. Other Rev Op Group members refused to give the Debtor a power of attorney (*e.g.* Mr. Lonnie Krueger). *See* DE #2219, Ex. I; L. Murphey Declaration, ¶¶20-22. *See also* DE #2219, Ex. C, L, M, P, Q (five additional investors who did not grant power of attorney to the Debtor pursuant to their note purchase agreement).

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1 *See* L. Murphey Declaration, ¶15, Ex. C (emphasis added).[5]

20. It is beyond dispute that the ML Manager is not entitled to a ruling in its favor based on the record before the Court on the "power of sale" issue or on any issue relative to the ML Manager's decision-making authority on behalf of all Non-Transferring Investors. Viewed in a light most favorable to the ML Manager, which frankly may be impossible under these circumstances, whether or not the ML Manager has "power of sale" or any decision-making authority over all Non-Transferring Investors is an issue that is the subject of factual and legal disputes that simply cannot be addressed in a contested matter, let alone through a non-evidentiary hearing. It will need to be addressed on a case-by-case basis.

21. Separate and apart from the foregoing problems, the Court should vacate the Supplemental Order because the ML Manager's argument that the form agency agreement and, specifically, Section 1(d) thereof provides the ML Manager with an "absolutely clear" power of sale is the subject of factual disputes beyond whether a blank form or specific contracts apply to a particular investor.

22. As the Court is well aware, the relationship between the Rev Op Group is evidenced by a number of contracts, and a private placement memorandum was involved in the investment process. In his declaration, Mr. Murphey lays out what he understood to be all of his contracts with the Debtor, although those facts are not crystal-clear at this point in time.[6] Again, resolving how these contracts work as a legal and factual matter simply is not possible in the context of a non-evidentiary hearing.

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[5] The ML Manager and its counsel has had this letter in its possession since at least October 8, 2009. See Rev Op Group's Summary/Reply, Ex. A. [DE #2272]

[6] The Rev Op Group asked for an appropriate representative of the ML Manager to provide a declaration stating all contracts have been provided but the ML Manager declined to so do. Instead, the ML Manager's legal counsel wrote a letter to try and address this issue. *See* L. Murphey Declaration, Ex. A.

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23. The ML Manager points to Section 1(d) alone and argues it provides absolute clarity on the "power of sale" issue. This argument fails, of course, with respect to those Rev Op Group members who did not give the Debtor such powers (*e.g.,* Mr. Murphey and Mr. Krueger). Even assuming, *arguendo*, the Court only looked in isolation at Section 1(d) of the form agency agreement (which is not a fair assumption), that section is ambiguous on its face.

24. Section 1(d) discusses the right to liquidate a participation interest, but it also discusses the concepts of *payment* and *reinvestment* in the next sentence. Presumably, the ML Manager does not think it has the power to reinvest the Non-Transferring Investors' note proceeds in other notes, but that appears to be the purpose of Section 1(d).

25. Comparing Section 1(d) to the private offering memorandum ("**POM**"), which is probably a necessary step since it was relied upon by Pass-Through Investors, yields more questions than answers on this issue. *See* L. Murphey Declaration, ¶19; Ex. D. While the POM discusses the agency agreement (POM, pp.37-38), it does not disclose a "power of sale" *except* in the context of an investor who fails to fund subsequent draws due to the underlying borrower. These representations (or the lack thereof) are in stark contrast to the argument presented by the ML Manager and adopted in the Supplemental Order.

26. The Court also should reconsider its "power of sale" ruling because it is distinctly possible that the Debtor terminated its contracts with all Pass-Through Investors prior to the petition date. Indeed, this possibility has been openly acknowledged in writing by counsel for the ML Manager. *See* L. Murphey Declaration, Ex. A. Indeed, Mr. Murphey's termination letter has been in the record since October 8, 2009. *See* Ex. A to DE #2272. *See also* L. Murphey Declaration, Ex. B-6.

27. Thus, the Rev Op Group requests that the Court simply vacate the Supplemental Order, and indicate these issues regarding "power of sale" are not resolved in the Memorandum Decision. There clearly are factual disputes regarding this issue.

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28. Moreover, while the Rev Op Group appreciates that the Court issued the Memorandum Decision on an emergency basis, Issues 6, 7, and 8 covered a wide range of subjects, and the ruling was made on a limited record. The Court's ruling that "[t]he ML Manager does have authority to deal with the loans and collateral securing the loans to the extent provided by the governing documents including but not limited to the applicable subscription agreements and agency agreements . . ." needs clarification.

29. There is a high likelihood of further litigation regarding the "governing documents" and legal effect thereof. The stakes are high, and the ML Manager's "blank form contract" theory cannot and clearly does not apply to investors like Mr. Murphey and Mr. Krueger.[7]

30. Thus, the Rev Op Group requests that the Court supplement the above-referenced ruling with the following: "Nothing in this Memorandum Decision resolves which specific contracts, if any, are binding on the ML Manager and any member of the Rev Op Group, or whether the ML Manager actually has decision-making authority with respect to any specific member of the Rev Op Group."

ISSUES NOS. 4 AND 5 – THE EXIT FINANCING

31. In its Memorandum Decision, the Court noted that Issues No. 4 and 5 "concern the right to charge a proportionate share of the exit financing and other liquidating fund expenses back against the Pass-Through Investors who do not opt in." On these issues, the Court ruled as follows:

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[7] The Rev Op Group reserves its rights on all of these issues and, in fact, disputes that the Debtor or the ML Manager has the right or power to make *any decisions* on their behalf. Mr. Murphey and Mr. Krueger are merely picked as two examples where the record is clear that the ML Manager should not prevail on its "sole authority" theory.

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> The motion for clarification is granted, to the extent any clarification is needed. Paragraph U of the confirmation order permits the ML Manager to charge back to the non-opt-in participating investors their proportionate share of all of its expenses, including but not limited to the exit financing. This Plan does impose a limitation that such charge back be fair, equitable and proportional, but within those limitations the ML Manager can exercise his business judgment whether to obtain financing to cover exit costs and operational expenses, and when to make the charge backs.

32. The Rev Op Group requests that the Court reconsider three aspects of this ruling in the Memorandum Decision. First, the Clarification Motion specifically requested a clarification as to whether or not the ML Manager had the right to impose non-expense burdens of the exit financing on the Non-Transferring Investors – *e.g,.* the seventy percent (70%) cash distribution that opt-in investors are committed to pay until the loan is paid in full, the ten percent (10%) "disposition incentive payment" that is capped at $8.0 million, and the three percent (3%) repayment incentive designed to encourage *borrowers* to repay the exit financing sooner rather than later. Those issues were not addressed in the Memorandum Decision.

33. From the Rev Op Group's perspective, there is no factual or legal basis for imposing any of these burdens on Non-Transferring Investors, who are not borrowers and are not entitled to any of the benefits of the exit financing. Disclosure Statement, p.7. Neither the Disclosure Statement nor Plan makes *any mention* of the ML Manager's power to divest Non-Transferring Investors' of their note proceeds for these purposes. Thus, the Rev Op Group requests that the Court clarify that neither the ML Manager nor the exit financier may impose these burdens on Non-Transferring Investors.

34. The second issue, with due respect to the Court, is the basic ruling set forth above. While the Rev Op Group is mindful of the fact that the Court was not involved in the negotiations or discussions that resulted in having Paragraph U inserted into the Confirmation Order, the Court's ruling results in the Rev Op Group being deprived of the benefit of its negotiated bargain. The Rev Op Group respectfully submits the Court's ruling is either an impermissible inference from disputed facts and/or is squarely refuted by the Plan and Paragraph U of the Confirmation Order.

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35. The Court ruled that Paragraph U "permits the ML Manager to charge back to the non-opt-in participating investors their proportionate share *of all of its expenses, including but not limited to the exit financing***.**" See Memorandum Decision (emphasis added). Paragraph U, however, only allows the ML Manager to assess to the non-opt-in participating investors "their proportionate share of costs and expenses *of serving [sic] and collecting the ML Loans* in a fair, equitable and nondiscriminatory manner." Confirmation Order, ¶U (emphasis added).

36. Thus, the Rev Op Group requests that the Court amend its decision so that the ML Manager is held to the language of Paragraph U of the Confirmation Order. To rule otherwise ignores the plain language of the Confirmation Order and the many provisions of the Plan making it clear that Non-Transferring Investors are not obligors under the exit financing. *See, e.g.,* Plan, ¶4.15.

37. The third and final amendment is that the word "serving" in Paragraph U obviously was intended to be the word "servicing." The Clarification Motion raised this issue and neither the ML Manager nor any other party challenged the Rev Op Group on this issue. Thus, the Rev Op Group respectfully asks the Court to clarify that the word "serving" should actually read "servicing" in Paragraph U of the Confirmation Order.

ISSUES NOS. 1, 2, 7, 9, AND 10

38. In its Memorandum Decision, the Court noted these particular issues were resolved according to the Rev Op Group's reply and, on that basis, denied the clarification motion as to those issues. As a threshold matter, to the extent that the Court continues to believe that the denial of the clarification motion regarding these issues is appropriate, the Rev Op Group requests that the Court amend the decision to make it clear the denial is "without prejudice."

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39. Only Issues Nos. 2, 7 and 9, however, are truly resolved, so the Rev Op Group requests certain clarifications so there is a clear record on these issues.[8] As to Issue No. 1, the Rev Op Group's reply expressly noted this issue was only partially resolved, and the specifically identified unresolved factual and legal issues. Thus, the Rev Op Group simply requests that the Court clarify that the denial of the clarification motion as to Issue No. 1 is "without prejudice."

40. As to Issue No. 10, the Rev Op Group noted in its reply that this issue was resolved because the ML Manager confirmed there have been no oral modifications to the Plan *and* it would provide a commercially reasonable accounting to all investors. However, the Rev Op Group believes it is in the best interests of all investors for there to be a *court order* requiring the ML Manager to provide a commercially reasonable accounting especially since this relief was not opposed by the ML Manager.

41. Rather than denying this aspect of the clarification motion, the Rev Op Group requests that the Court add to the Memorandum Decision the following: "The ML Manager shall provide all investors with periodic, commercially reasonable accountings, and any disputes regarding the timing and sufficiency of such accountings will be resolved by the Court."

CONCLUSION

For all of the foregoing reasons, the Rev Op Group requests that the Court enter an order reconsidering the Memorandum Decision (as amended) to address the above-referenced issues; and granting the Rev Op Group any other and further relief as may be just and proper under the circumstances of this Chapter 11 case.

[8] Issue No. 2 is resolved because the ML Manager provided the Rev Op Group and the Court with the form of assignment document pursuant to which the ML Manager contends it is assignee of contracts between the Rev Op Group and ML. Issue No. 7 is resolved because the ML Manager concedes, as it must, that it has no authority to encumber the notes of Non-Transferring Investors. Issue No. 9 is resolved because the ML Manager filed the Inter-Borrower Agreement with the Court.

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DATED this 30th day of October, 2009.

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/s/ Sally Erwin

EXHIBIT “A”

Erwin, Sally

From: Miller, Robert
Sent: Wednesday, October 21, 2009 7:56 AM
To: 'REECE, CATHY'
Cc: S. Cary Forrester (scf@fwlawaz.com)
Subject: ML -- Final Request

As you know, you and your client previously committed to having all of the contracts between ML and my clients delivered to me early last week. After that window passed with no communication or delivery of documents, I contacted you and you then told me your client was in the process of locating the contracts. I received a nonresponse as to when they would be delivered. Another week has passed. Therefore, my clients' final position on this matter is as follows:

By no later than COB this coming Monday, your client must deliver full and complete copies of all such contracts to my office *along with* a declaration by an appropriately authorized representative of your client. The declaration needs to say that, after diligent inquiry and to the best of his/her knowledge, information, and belief, the attached contracts represent all of the written contracts between ML and my clients, and language clarifying which of these contracts were assigned pursuant to the plan. (The latter point is important because I believe your position is the purchase contracts were not assigned, although the assignment document attached to your response to the motion to clarify indicates otherwise.) As you know, a list of my clients is attached to the motion to clarify for ease of reference.

If all of the foregoing is not in my office by COB Monday, then on Tuesday the Rule 2004 papers will be filed. To be clear, both items are required -- the contracts and the declaration. I can't be left in the position of telling my clients I have no way of actually confirming that your client made a diligent inquiry to locate and deliver *all* contracts. The declaration is the simplest device I can think of to address that issue.

P.S. Is Monday carved in stone? No. But since you have yet to tell me when I will be receiving them and the initial commitment was over a week ago, I feel I have little choice other than to set a hard date. Plus, your client has a fiduciary duty to my clients in my view, and I would think your client would want to immediately turn over this information since it is relevant to the opt-in/out decision that your client unilaterally decided to reset to 10/31. I don't want to be in the position of having to consider filing a motion to extend the 10/31 deadline because of your client's inability to get these contracts to us early enough for them to be digested before the 10/31 deadline.

Please call or write if you have any questions.

Bob

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