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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 **RESPONSE TO ML MANAGER'S MOTION FOR FEES AND COSTS** Hearing Date: 12/7/09 Hearing Time: 11:00 a.m.

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This Response is filed by the Rev Op investors who collectively hold approximately $58.4 million in Rev Op investments (collectively, the **"Rev Op Group"**) and the Sternberg Enterprises Profit Sharing Plan (the "**Sternberg Plan**"), in opposition to the ML Manager LLC's Motion For Attorneys' Fees And Costs Re Rev Op Group's Motion or Clarification And Related Joinders dated November 18, 2009 (the "**Sanctions Motion**"). This Response is supported by the declaration of Louis B. Murphey dated October 30, 2009 (the "**Initial Murphey Decl.**") [DE #2353], and the supplemental declaration of Mr. Murphey attached hereto as Exhibit A (the "**Supp. Murphey Decl.**").

INTRODUCTION

1. The Sanctions Motion is not so much a motion based on fact and law as it is a rant by the ML Manager and its counsel seeking revenge on the Rev Op Group, the Sternberg Plan, a number of other pass-through investors, and their lawyers, who had the

audacity to ask this Court to enter an order clarifying a chapter 11 plan and confirmation order. The Sanctions Motion is devoid of any merit and should be denied by the Court.

FACTUAL AND PROCEDURAL BACKGROUND

2. On September 14, 2009, the Rev Op Group filed its clarification motion with respect to the confirmed plan and the confirmation order. [DE #2168] Numerous parties filed joinders. In those pleadings, the Rev Op Group and the joining parties raised a number of issues to be clarified by the Court prior to the fast-approaching deadline that applied to all pass-through investors with respect to the transfer of their interests in notes to the Loan LLCs.

3. The ML Manager filed a lengthy objection to the clarification motion. [DE #2265] After a brief non-evidentiary hearing, the Court issued a memorandum decision ruling on a number of those issues. See Memorandum Decision dated October 21, 2009 (the "**Memorandum Decision**").

4. Pursuant to the Sanctions Motion, the ML Manager seeks to have the Rev Op Group, the parties who filed joinders, and all of their lawyers sanctioned and held liable to pay the fees incurred by the ML Manager in this contested matter – $26,758.25. The ML Manager argues that the clarification motion was filed in bad faith and for an improper purpose. The ML Manager contends the clarification motion and joinders "did not present a single debatable issue." The ML Manager further contends the clarification motion presented procedurally improper objections that the Court held were either not ripe or moot. See Sanctions Motion, p.5, lns. 15-16. The ML Manager's arguments are refuted by the record before the Court.[1]

5. Interestingly, the Sanctions Motion does not contain a fact section. The Sanctions Motion contains only argument about what transpired in connection with this

[1] The ML Manager also claims the clarification motion raised "untimely plan objections." Motion, p.5, lns. 13-15. This is factually and legally false. Counsel for the ML Manager surely understands the difference between a plan objection and a motion to clarify a confirmation order and plan.

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contested matter. There are several uncontrovertible facts, however, relevant as to why the Court should deny the Sanctions Motion.

6. While the Memorandum Decision speaks for itself, the Court ***granted*** the Rev Op Group's request for clarification on Issues No. 6, 7, and 8, which addressed the extent of the ML Manager's authority to make decisions with respect to the notes of non-transferring investors. The Court made it clear the ML Manager's decision-making authority was and is "to the extent provided by the governing documents . . ." Memorandum Decision, p.2.

7. The Court's ruling on these issues is contrary to the position taken by the ML Manager in this contested matter. The ML Manager argued in its response that it had "sole discretion" to make all decisions on behalf of non-transferring investors. See Response, p.9.

8. Immediately after receiving the Memorandum Decision, the ML Manager filed an emergency motion asking the Court to delete the words "sell or" from the Memorandum Decision, so the ML Manager would have the benefit of a court order stating the ML Manager has the right to sell interests of non-transferring investors in notes without their consent.[2] [DE #2327] The Court made that requested deletion pursuant to its Order dated October 28, 2009. [DE #2338]

9. The Rev Op Group challenged this move by the ML Manager through a reconsideration motion. [DE #2352] In ruling on the reconsideration motion, the Court clarified that "deleting the reference to the lack of such authority does not constitute a ruling that the ML Manager has such authority. That issue remains to be decided when it

[2] The ML Manager stated that striking the "sell to" language of the Memorandum Decision "would affirm that ML Manager does not have the right to encumber fractional interests in the loans . . ., but that the ML Manager does have all of the rights set forth in the Agency Agreements, ***such as the right to sell the interest in the Loan*** . . ." Motion dated October 22, 2009, pp.4-5 (underlines in original; italics and bold face added). [DE #2327]

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actually arises and is properly presented to the Court for decision." See Order dated November 4, 2009.

10. Thus, the ML Manager sought and failed to obtain a court order giving it the right to sell interests of non-transferring investors in notes without their consent. This issue remains open to debate, as do essentially all of the other issues regarding the authority of the ML Manager to make such decisions on behalf of non-transferring investors. (Only the ML Manager's inability to encumber the interests of these parties has been resolved through this contested matter; the ML Manager conceded this issue.)

11. The other key, debatable issues that remain relate to the Court's rulings on the exit financing. Obviously, the Court ruled in favor of the ML Manager on these issues. With due respect to the Court, however, these issues are the subject of an appeal before the United States Bankruptcy Appellate Panel of the Ninth Circuit. Given the fact that: (i) Paragraph U of the confirmation order says what it says; (ii) non-transferring investors are not borrowers on the exit financing; and (iii) the disclosure statement accompanying the plan plainly states the use of the exit financing will not be available to non-transferring investors, there was and is a legitimate debatable issue as to whether the burdens of the exit financing may be imposed on non-transferring investors.

12. The Court also needs to consider the path that led to the filing of the clarification motion by the Rev Op Group. The Rev Op Group's clarification motion was only filed after the ML Manager and its counsel failed to provide "straight answers" to relatively straightforward questions regarding the plan and how it was supposed to work. Initial Murphey Decl., ¶¶3-4.

13. Prior to the hearing on the clarification motion, the Rev Op Group, joined by the Lewis Trust and the Underwood Trust, also sought a meeting with the ML Manager and Mr. Kevin O'Halloran, the trustee of the liquidating trust, in an effort to resolve these issues. The meeting occurred October 5, 2009. A couple of issues (e.g., the accounting issue) were resolved at the meeting. Supp. Murphey Decl. ¶¶3-6.

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14. On the key issues of authority and the imposition of exit financing costs, the Rev Op Group, the Lewis Trust, and the Underwood Trust presented proposals at the meeting in an effort to resolve those issues, or at least create a framework for the resolution of those issues. The ML Manager and the liquidating trustee did not agree with the proposals ***and*** refused to make any kind of counterproposal. Id. at ¶¶10-14.

15. Thus, the Rev Op Group was given a choice of capitulating to the ML Manager or going forward with the hearing so clarifications could be provided by the Court. The Rev Op Group chose to go forward with the hearing for obvious, legitimate reasons – to obtain clarifications on these issues before the transfer decision had to be made by pass-through investors.

LEGAL ANALYSIS

16. The ML Manager's legal analysis is fatally flawed. The ML Manager's core line of cases are Rainbow Magazine, Inc., 77 F.3d 278 (9th Cir. 1996) and its progeny. The Rainbow decision stands for the basic proposition that, in the right egregious circumstances, a bankruptcy court has the inherent authority under section 105 of the Bankruptcy Code to sanction a party who "abused the bankruptcy process in bad faith." Id. at 283-84.

17. A cursory review of the Rainbow decision and the other cases cited by the ML Manager makes it obvious they simply do not apply here. An interesting and relevant shortcoming to the Sanctions Motion is the ML Manager's failure to discuss the facts of ***any*** of the cases cited therein.

18. In Rainbow, the trial court ruled that the sanctioned party signed a false statement of financial affairs in violation of Bankruptcy Rule 9011 – i.e., he was hiding assets. He also filed a bankruptcy petition in bad faith in what the trial court found to be an elaborate scheme to divert $180,000 contrary to the instructions of a chapter 7 trustee. The trial court found this conduct to be a "classic case of 'apartment house hijacking.'" Id. at 280.

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19. On appeal, the sanctioned party did not dispute the facts established by the trial court. Id. at 279. Instead, he argued the trial court had no authority to sanction him $250,000 under the court's inherent powers. Id. at 283. Here, the facts are totally different than the egregious situation in the Rainbow decision.

20. The ML Manager argues that Silberkraus, 253 B.R. 890 (Bankr. C.D. 2000), supports its position. Silberkraus was a bad faith filing where the individual debtor filed chapter 11, fought stay relief and other actions of its key creditors, and then seven months after the filing conceded he had no ability to reorganize without the consent of these creditors. Id. at 894-901.

21. In summary, Rainbow, Silberkraus, and the other cases cited by the ML Manager have literally no factual similarities, and are legally inapplicable, to the instant case. Moreover, the ML Manager has not cited a single case where a party seeking clarification of a plan or confirmation order was sanctioned by a court. The ML Manager simply has no facts or case law to back up its flawed argument for sanctions.

22. The ML Manager also argues that the Rev Op Group's clarification motion was filed for an improper purpose – allegedly trying to alter or modify the plan -- "outside any statutory framework allowing for such change." This is false. The Rev Op Group's motion sought ***clarification*** of the plan and confirmation order. In support of this request, the Rev Op Group cited to a line of cases, including Ninth Circuit authority, that the Court retains the jurisdiction and has the authority to interpret its own orders, including the confirmation order.[3]

23. The ML Manager makes two additional arguments the Court should discard. The ML Manager contends that Bankruptcy Rule 9011 somehow supports its position. See Sanctions Motion, p.3. Even assuming Rule 9011 provided some basis for

[3] The clarification motion cited to the following cases: In re Taylor, 884 F.2d 478 (9th Cir. 1989); In re Franklin, 802 F.2d 324 (9th Cir. 1986); Hawaiian Airlines, Inc. v. Mesa Air Group, Inc., 355 B.R. 214, 218 (D. Hawaii 2006) (citing In re Petrie Retail, Inc., 304 F.3d 223, 230 (2d Cir. 2002)).

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relief by the ML Manager, which it does not for the very same reasons the Rainbow argument must fail, the ML Manager never complied with the procedures mandated by Bankruptcy Rule 9011. Thus, the ML Manager's argument under Bankruptcy Rule 9011 must fail.

24. Finally, the ML Manager adds a paragraph in its Sanctions Motion arguing that courts have considered a confirmed plan to be a contract, so it is entitled to an attorneys' fee award as a matter of contract law and A.R.S. § 12-341.01. Importantly, the ML Manager (once again) fails to cite a single case where a fee award was granted under that legal theory.

CONCLUSION

The Rev Op Group filed the clarification motion for the reasons set forth therein, and those reasons were and are legitimate. The same is true for the Sternberg Plan and its joinder. These parties wanted this Court's unbiased views on the issues presented in the context of deciding whether or not to transfer their interests into the applicable Loan LLCs formed under the plan. The Court's rulings thereon provided the Rev Op Group – and all pass-through investors – with information important to their transfer decision. The ML Manager's frustration with the fact a group of investors sought and obtained these clarifications provides no basis for relief for the ML Manager. Thus, the Sanctions Motion should be denied by the Court.

DATED this 30th day of November, 2009.

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By /s/ RJM, #013334
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EXHIBIT “A”

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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 **SUPPLEMENTAL DECLARATION OF LOUIS B. MURPHEY**

I, Louis B. Murphey, declare as follows:

1. I am an adult person over the age of twenty-one (21). I am a resident of Saint David, Arizona, and I have personal knowledge of the facts recited herein.

2. I am one of several individuals and entities represented by Bryan Cave LLP, which group is generally referred to as the "Rev Op Group." I personally invested $6.0 million in Mortgages Ltd.

3. The Rev Op Group filed its clarification motion on September 14, 2009. Thereafter, the Rev Op Group, the Lewis Trust, and the Underwood Trust tried to set up a meeting with the ML Manager and the trustee of the liquidating trust, Mr. Kevin O'Halloran, in an effort to resolve or narrow the issues raised in the clarification motion. We met on October 5, 2009.

4. At the meeting, the Rev Op Group was represented by Bill Hawkins and me; Bob Miller attended as our legal counsel. We were joined by Cary Forrester, who attended as counsel on behalf of the Lewis Trust and the Underwood Trust. Mark

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Winkleman attended as business representative of the ML Manager; Cathy Reece attended as its counsel. Mr. O'Halloran also was in attendance, represented by Scott Jenkins.

5. The October 5 meeting was lengthy. At the request of Ms. Reece, we came to the meeting prepared to discuss every issue raised in the clarification motion, along with proposed solutions to these issues.

6. Two of the issues were quickly resolved. The ML Manager's representatives acknowledged that the ML Manager had no authority to encumber any of the Rev Op investors' interests in the notes and deeds of trust. The ML Manager's representatives also agreed to provide investors with a commercially reasonable accounting.

7. The last business day prior to this meeting (October 2, 2009), the ML Manager had filed its response to the clarification motion, so we knew the ML Manager's position on most of the issues raised in the clarification motion. The ML Manager's response resolved, in part, a couple of additional issues.

8. Specifically, the ML Manager attached a copy of its assignment document to the response. Thus, we generally knew the ML Manager's position with respect to the first two issues raised in the clarification motion: (i) the status of the various agreements as they related to the Rev Op Group; and (ii) how the ML Manager came to hold any contractual rights it contended were binding on members of the Rev Op Group.

9. What remained unresolved then as a factual matter is when the ML Manager intended to give copies of these contracts to the Rev Op Group members. Ms. Reece told us that we would be given copies of the relevant contracts the following week. As discussed in my declaration dated October 29, 2009, those contracts were actually delivered on October 26 – a week after the Court issued its initial memorandum decision on the clarification motion.

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10. Most of the meeting time on October 5 was devoted to discussing the exit financing and authority issues. Again, at the request of the ML Manager, we came to the meeting with proposals on how to address these issues.

11. As to the issue of how authority issues could be addressed on a going forward basis, we proposed that the ML Manager consider implementing a "major decision" approval process much like the existing process provided for in the plan, so that the non-transferring investors' input would be solicited and counted like the members of the Loan LLCs.

12. As to the issue of exit financing and the allocation of those costs, we told them that a key problem from our perspective was that, to the best of our knowledge, nobody had actual factual analysis available on the current cost of the exit financing and how the ML Manager proposed to allocate it among the Loan LLCs and the non-transferring investors. The Rev Op Group certainly had no access to the specific debt numbers and how the ML Manager proposed to allocate this debt across the various parties.

13. Thus, we asked the ML Manager to work with Ed McDonough to prepare an analysis of how the existing balance of the exit financing was proposed to be allocated across the loan portfolio. Our goal was that, by getting real numbers on the table rather than concepts, we could begin the process of actually trying to sort out who owed what and how it would get paid.[1] Neither the ML Manager's representatives nor the

[1] This concept applied retroactively and prospectively. From the perspective of the Rev Op Group as a whole and from my personal perspective, we knew we would have to bear an appropriate burden of the costs associated with Mortgages Ltd.'s "exit" from chapter 11, although it needed to be subject to the other constraints of the plan as confirmed by the Court -- e.g., Paragraph U of the confirmation order. On a going forward basis, we also expected to be assessed for appropriate charges, rather than having the ML Manager borrow amounts to pay these charges which would only create additional needless expense (e.g., interest expense owed to the exit financier). We simply wanted to start the process of resolving these issues by having the ML Manager tell us how much they thought everyone would have to pay to date.

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liquidating trustee agreed to provide this information. They refused to support this approach.

14. After much discussion, no real progress was made on these two crucial issues. We closed the meeting by asking the ML Manager and the liquidating trustee to make some sort of alternative proposal, so that the Rev Op Group and Mr. Forrester's clients could consider what they proposed as alternative solutions. They refused to make any kind of alternative proposal, so the meeting ended.

I declare under penalty of perjury the foregoing is true and correct to the best of my knowledge, information and belief.

DATED this 30th day of November, 2009.

Louis B. Murphey

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