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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 **OBJECTION TO ML MANAGER'S MOTION TO APPROVE SETTLEMENTS WITH GRACE ENTITIES** Hearing Date: May 27, 2010 Hearing Time: 10:00 a.m.

The members of the Rev Op Group as more particularly identified on Exhibit A attached hereto (collectively, the "Rev Op Investors")[1] hereby file this Objection to the *Motion To Approve Settlements With Grace Entities* (the "Motion") filed by ML Manager LLC ("ML Manager") on May 18, 2010 [DE #2743]. The Motion improperly seeks to resolve, on an expedited basis, the "agency authority" issues that are currently pending in the adversary proceeding commenced by ML Manager against the Rev Op Group. The Court should decline ML Manager's invitation to issue a declaratory judgment pursuant to a motion on one week's notice to the Rev Op Group. The Motion is also premature, as various conditions precedent to

[1] Although the Rev Op Group believes it has identified its members with fractional interests in the relevant loans, this Objection is being filed on an expedited basis, and the Rev Op Group reserves the right to amend Exhibit A or make any other corrections necessary to ensure that all of the members of the Rev Op Group with interests in the relevant loans are included in this Objection.

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the proposed settlement must be resolved before ML Manager's proposal becomes a true settlement in prospect. Importantly, the various Loan LLCs entitled to vote on whether to reject the proposed settlement should make their decisions before the settlements are presented to the Court. The two Loan LLCs being asked to pay the full financial consideration of the settlement for all six loans are likely to reject the proposed settlements. A rejection by any one Loan LLC would result in all of the other settlements becoming ineffective.

In addition, ML Manager has woefully failed to show how the proposed settlements are in the best interest of investors, particularly the Rev Op Investors. It is no secret that ML Manager has exhausted, or is very close to exhausting, its exit financing under the Plan. ML Manager recently filed and then withdrew another "emergency" motion for the sale of real property at a fire-sale price, ostensibly due to the superior offer of a competing purchaser. *See* Blackeye Capital, L.L.C.'s *Response to Motion/Application to Sell Real Property Free and Clear of Liens, Claims, Encumbrances and Interests* [DE #2759]. The Rev Op Investors spent considerable resources having counsel draft an objection to the "emergency" sale motion only to have it withdrawn at the eleventh hour, and similarly was forced to incur significant expense defending an improperly obtained order to show cause upon ML Manager's commencement of the Adversary Proceeding.

The Rev Op Group fears that ML Manager is making increasingly desperate decisions, with the Court and parties in interest serving as the only "reality check." The Court and all parties would do well to question the judgment of ML Manager under its current state of duress and indecision, and particularly with respect to the proposed settlements on an emergency motion that contains virtually no information for the Court to make the required "fair and equitable" determination. The Motion should be denied, and ML Manager should be ordered immediately to cease and desist from filing motions to determine issues that must be adjudicated in the Adversary Proceeding.

In further support of this Objection, the Rev Op Investors respectfully submit as follows:

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I. FACTUAL AND PROCEDURAL BACKGROUND.

1. On June 20, 2008 (the "Petition Date"), an involuntary Chapter 7 bankruptcy petition was filed against Mortgages Ltd., the debtor in the above-captioned bankruptcy case ("Debtor"), which case was subsequently converted to a case under Chapter 11 of the Bankruptcy Code.

2. At various times prior to the Petition Date, Debtor made the following loans to certain limited liability companies collectively referred to in these proceedings as the "Grace Entities": (i) a loan to Central & Monroe, LLC ("Central & Monroe") in the sum of $75,600,000 (the "Central & Monroe Loan"); (ii) a loan to Osborn Partners III, LLC ("Osborn") in the sum of $41,400,000 (the "Osborn Loan"); (iii) a loan to Portales Place Property, LLC in the sum of $32,000,000; (iv) a loan to 70th Street Property, LLC in the sum of $11,395,000; (v) a loan to 44th & Camelback Property, LLC in the sum of $10,900,000 (the "44th & Camelback I Loan"); and (vi) a loan to 44th & Camelback Property, LLC in the sum of $10,200,000 (the "44th & Camelback II Loan").

3. Debtor sold all of its interests in each of the loans and in the corresponding collateral securing the loans to various investors, who received fractional interests in such loans and the corresponding loan collateral. The Rev Op Investors purchased fractional interests in certain of the Grace Entity loans, including the Central & Monroe Loan and the Osborn Loan.

4. On March 12, 2009, the Official Investors Committee filed its *First Amended Plan of Reorganization Dated March 12, 2009* (the "Plan") in Debtor's bankruptcy case, which provides for the creation of certain Loan LLCs to hold the loans originated by Debtor.

5. On May 20, 2009, the Court entered its *Order Confirming Investors Committee's First Amended Plan of Reorganization Dated March 12, 2009*, thereby approving the Plan as modified therein. Thereafter, all the fractional interests of "opt-in" transferring investors were transferred to the respective Loan LLCs. In particular, all of the applicable opt-in investors' fractional interests in the loans to the Grace Entities were transferred to one of six respective Loan LLCs formed to hold interests related to the respective Grace Entity loans.

6. The Rev Op Investors, however, elected to retain their fractional interests in the Grace Entity loans. Such interests were not transferred to the Loan LLCs and are still held by the Rev Op Investors.

7. ML Manager, as manager for the six Loan LLCs that hold interests in the Grace Entity loans, has entered into a total of five separate settlement agreements with the respective Grace Entities that purport to resolve all legal issues between the Grace Entities (and related guarantors) and all parties holding fractional interests in the loans to the Grace Entities. ML Manager purports to bind the Rev Op Investors to the settlements by virtue of its asserted agency authority, which is disputed and is the subject of a pending adversary proceeding, Adv. No. 2:10-ap-00430-RJH (the "Adversary Proceeding").

8. Each of the settlement agreements sets forth the terms upon which ML Manager can foreclose upon the property securing each respective loan or request a deed-in-lieu of foreclosure (except with respect to the 44th & Camelback I Loan and the 44th & Camelback II Loan, whereby ML Manager has agreed not to foreclose its second position liens on the property securing these loans).

9. Pursuant to the Osborn Loan settlement agreement, ML Manager has agreed to pay the legal fees incurred by ***all*** of the Grace Entities in the sum of $510,000, and has agreed to pay an additional $365,000 to Osborn or its designee. These sums are to be evidenced by separate promissory notes, secured by a deed of trust on the property securing the Osborn Loan, and paid from the proceeds of the sale or refinancing of the property securing the Osborn Loan.

10. Pursuant to the Central & Monroe Loan settlement agreement, ML Manager has agreed to pay three separate sums in the amounts of $230,000, $260,000, and $125,000 to Central & Monroe or its designee, which sums are to be evidenced by a promissory note, secured by a deed of trust on the property securing the Central & Monroe Loan, and paid from the proceeds of the sale or refinancing of the property securing the Central & Monroe Loan, among other things.

11. In total, ML Manager seeks (i) to charge a total of $875,000 to the collateral securing the Osborn Loan to pay legal fees for all of the Grace Entities and to pay certain

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unidentified creditors of all of the Grace Entities and their guarantors, and (ii) to charge a total of $615,000 to the collateral securing the Central & Monroe Loan to pay certain unidentified creditors of all of the Grace Entities and their guarantors. Thus, the settlements require a total of nearly $1.5 million in the aggregate to be paid to the Grace Entities or their designees.

12. Such amount is to be taken from the collateral of the investors in the Osborn Loan and the Central & Monroe Loan—i.e., the settlements result in a surcharge of the investors in those two loans to pay for the legal fees and other undisclosed expenses of the Grace Entities. None of the other settlement agreements with respect to the other loans seeks to surcharge the collateral securing such loans.

13. ML Manager asserts, on belief only, that the sums to be paid from Osborn and Central & Monroe are to be used by the Grace Entities as a group to pay certain of the Grace Entities' (and their guarantors') unnamed creditors in an effort to dissuade these creditors from pursuing legal action against the Grace Entities and their guarantors. No information is provided regarding the staggering amount of asserted legal fees of the Grace Entities. Neither the Motion nor any of the settlement agreements contains a pro rata breakdown of the legal fees and creditor claims to be paid by each of the Grace Entities.

14. Although the Motion attempts to avoid the issue, it is clear that the fractional beneficial interests of the Rev Op Investors under the deeds of trust securing the loans to the Grace Entities will be effectively subordinated to interests granted to the Grace Entities pursuant to the proposed settlements. To the extent the relevant Loan LLC and Rev Op Investors take title to collateral by credit bid in a trustee's sale or through a deed in lieu, the Grace Entities receive a first-position deed of trust on the real estate asset owned by the Loan LLC and Rev Op Investors. To the extent such collateral is sold to a third party, the Grace Entities receive first payment from the sale proceeds. In sum, the settlements seek to prime the interests of the Rev Op Investors.

15. The members of the relevant Loan LLCs have the right to vote on whether to reject the proposed settlements, because the settlements "release collateral for the Loan without consideration equal to the fair market value of the collateral released as determined by the Manager." *See* Loan LLC Operating Agreement, attached as Exh. K to *Approved Amended*

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Disclosure Statement in Support of First Amended Plan of Reorganization dated March 12, 2009.

16. The settlements also would result in the release of the guarantors of the loans to the Grace Entities. ML Manager has not yet verified the financial condition of the guarantors, but alleges on belief only that they are insolvent.

17. The settlements are also contingent on the fulfillment of various conditions precedent. First, each settlement must be approved by a vote of the majority of the members of the applicable Loan LLC. The approval provisions of the settlements are interdependent. A rejection by any one of the Loan LLCs of its proposed settlement renders the other settlements ineffective.

18. In addition, ML Manager must obtain the exit lender's consent to the settlements. ML Manager also is required to verify the corporate authority of borrowers to enter into the proposed settlements. Although the settlement agreements appear to have been executed one month ago, the Motion does not discuss the status of these contingencies.

19. The settlements also provide for verification of the guarantors' insolvency by a forensic accountant, who apparently has not yet been retained by ML Manager.

20. Thus, ML Manger seeks, on expedited hearing, to surcharge investors' collateral for more than $1.4 million pursuant to the settlements, even though: (i) approval of the Motion requires collateral adjudication of the pending Adversary Proceeding, which ML Manager itself commenced; (ii) members of the Loan LLCs have not yet voted to approve the interdependent settlements; (iii) ML Manager has not verified the corporate authority of the Grace Entities; (iv) ML Manager has not obtained the consent of its exit lender to the settlement; and (v) ML Manager has not verified the insolvency of the guarantors, who would receive releases under the settlement.

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II. LEGAL ARGUMENT.

A. ML Manager Improperly Seeks To Obtain A Collateral Ruling On Agency Authority Issues That Are Currently Pending In The Adversary Proceeding.

First and foremost, the Motion improperly seeks to resolve, on an expedited basis, the "agency authority" issues that are currently pending in the Adversary Proceeding commenced by ML Manager against the Rev Op Group. It is hornbook law that certain matters must be resolved by an adversary proceeding rather than a motion. *See* Fed. R. Bankr. P. 7001. Courts have routinely and uniformly rejected attempts, like that of ML Manager here, to circumvent the requirement of an adversary proceeding under Bankruptcy Rule 7001. *See*, *e.g.*, *In re Golden Plan of Cal., Inc.*, 829 F.2d 705, 711 (9th Cir. 1987); *In re Colortran, Inc.*, 218 B.R. 507, 510-11 (9th Cir. 1997); *In re Johnson*, 346 B.R. 190, 195-96 (BAP 9th Cir. 2006); *In re Cogliano*, 355 B.R. 792, 804-05 (BAP 9th Cir. 2006).

Well aware of this principle, ML Manager initiated the Adversary Proceeding by filing its complaint for declaratory judgment to determine whether it has an irrevocable agency power to make decisions regarding the Rev Op Group's fractional interests in certain promissory notes, deeds of trust, and real estate assets (including the loans to the Grace Entities). Each member of the Rev Op Group filed counterclaims or a separate complaint raising issues relating to, among other things, the agency authority issue. The Rev Op Group has agreed to expedited briefing on motions for summary judgment and to expedited scheduling for discovery and trial, as necessary, in the Adversary Proceeding. Just yesterday, ML Manager filed an extensive motion for judgment on the pleadings with respect to various issues not addressed in the Rev Op Group's motions for partial summary judgment. ML Manager's sudden decision to raise by expedited motion the very issues pleaded in the Adversary Proceeding is puzzling, at best.

ML Manager may not obtain a disguised declaratory judgment through its Motion. Specifically, ML Manager may not obtain, pursuant to its accelerated Motion, a final order approving "entry into the settlements by ML Manager acting . . . ***as agent of the non-transferring Pass-Through Investors***" and authorizing "ML Manager to conduct trustee's sales with respect to the four properties ***on behalf of . . . their respective non-transferring Pass-***

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1 ***Through Investors***." *See* Motion, p.11 (emphasis added). The Motion also requests that the
2 Court order the Rev Op Investors to execute transfer documents as necessary to satisfy the title
3 company. The Rev Op Investors dispute ML Manager's authority to bind them to the proposed
4 settlements and to sell the collateral securing their fractional interests without their consent, and
5 the Rev Op Investors certainly dispute ML Manager's authority to force them to transfer their
6 valuable ownership interests in the relevant loans and collateral. These issues are squarely
7 before the Court in the Adversary Proceeding and must be resolved therein. The Motion should
8 be denied on this basis alone.

9 **B. Court Approval Of The Settlement Agreements Is Premature.**

10 Even if the agency issues were properly before the Court pursuant to the Motion (which
11 they are not), the Motion is grossly premature. Several conditions precedent must be satisfied
12 before the proposed settlements should be considered by the Court. Even though the settlements
13 are subject to the approval of the members of the relevant Loan LLCs, voting has not taken
14 place. Indeed, ML Manager apparently has not even delivered ballots to the members of the
15 Loan LLCs. *See Motion*, p.3. By ML Manager's own admission, the voting process will not be
16 completed prior to the hearing on the Motion. *Id.*, p.3–4. A vote by any one of the Loan LLCs
17 to reject the proposed settlement would result in ***all*** of the settlements being rejected. Thus, a
18 rejection vote on any single settlement would render the entire Motion moot, and the Court will
19 have issued a useless advisory opinion. *See In re Dumont*, 581 F.3d 1104, 1112 n.14 (9th Cir.
20 2009) ("[I]t is a rule of long standing that federal courts may not issue advisory opinions."). As
21 discussed below, in light of the disproportionate allocation of expenses to only two of the loans,
22 a vote to reject at least one of the proposed settlements is likely.

23 In addition, ML Manager has not yet obtained financial information from the borrowers'
24 principals and guarantors, who would receive releases under the settlements. This lack of
25 financial information makes it extremely difficult for the Court and investors to evaluate the
26 reasonableness of the proposed settlements, as discussed below. In fact, ML Manager has failed
27 to provide any information, beyond bald assertions, regarding the relevant conditions precedent
28 to the settlement. Based on current information, it is nearly impossible for opt-in investors to

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evaluate the settlements properly prior to voting. Relevant conditions precedent include: (i) the exit lender's consent to the settlements; (ii) verification of the guarantors' insolvency by a forensic accountant, who is yet to be retained by ML Manager; and (iii) verification of the corporate authority of borrowers to enter into the proposed settlements. Absent the occurrence of these conditions precedent, it is premature for this Court to consider approval of the Motion; and even upon their occurrence, an evidentiary hearing is necessary for ML Manager to carry its burden of proving the proposed settlements are fair and reasonable, and in the best interest of the Rev Op Investors.

ML Manager offers no justification for the highly questionable sequencing of the Motion and voting; nor has ML Manager articulated any necessity for accelerated consideration of the Motion. The only urgency seems to be ML Manager's desire to obtain the Court's contingent and advisory "blessing" on the settlements before ML Manager, with Court order in hand, calls for quick votes from already bewildered opt-in investors. In short, all that ML Manager has demonstrated is a remarkable failure to consider the "paramount interests" of investors, and in particular the Rev Op Investors, in reaching the proposed settlements. Despite the existence of several conditions precedent that should have already been accomplished, and certainly still may be accomplished within a reasonable time, ML Manager has brought this matter to the Court on an expedited basis in what appears to be a desperate attempt to hastily consummate the settlements. The Court should decline ML Manager's request to issue a contingent advisory opinion, particularly when the relevant conditions precedent would permit the Court and parties in interest to evaluate the propriety of the proposed settlements in a proper evidentiary hearing.

C. The Settlement Agreements Are Not Fair And Equitable.

A settlement must be "reasonable" and "fair and equitable," *In re A&C Properties*, 784 F.2d 1377, 1381 (9th Cir. 1985), *cert. denied*, 479 U.S. 854 (1986), and must be in the best interests of creditors, *In re Mickey Thompson Entmt. Group, Inc.*, 292 B.R. 415, 420 (9th Cir. BAP 2003); *In re MGS Mktg.*, 111 B.R. 264, 266-67 (9th Cir. BAP 1990). The party proposing the settlement "has the burden of persuading the bankruptcy court that the compromise is fair and equitable and should be approved." *A&C Properties*, 784 F.2d at 1381. Approval of a

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settlement, without a "sufficient factual foundation which establishes that it is fair and equitable, inherently constitutes an abuse of discretion." *Id.* Even in the absence of any objection to the proposed settlement, the bankruptcy court must make an independent analysis of the relevant factors bearing on whether a compromise is fair and equitable. *In re Churchfield*, 277 B.R. 769, 774 (Bankr. E.D. Cal. 2002).

The Ninth Circuit has identified four factors relevant to determining the appropriateness of a settlement: (a) the probability of success in the litigation; (b) the difficulties, if any, to be encountered in the matter of collection; (c) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (d) the paramount interest of the creditors and a proper deference to their reasonable views in the premises. *In re Woodson*, 839 F.2d 610 (9th Cir. 1988); *In re A & C Properties*, 784 F.2d at 1381.[2] ML Manager has failed to carry its burden of proving these elements—in fact, ML Manager has failed altogether to address these elements. The Motion fails to provide details that might permit the Court or any party in interest to evaluate the proposed settlement under the *Woodson* standard.

Even without the relevant details, however, it is clear that the proposed settlement is not fair and equitable to the investors holding fractional interests in the Osborn Loan and the Central & Monroe Loan. Simply stated, ML Manager seeks to surcharge the collateral of investors who hold fractional interests in the Osborn Loan and the Central & Monroe Loan for all of the costs associated with the settlement, a total sum of $1,490,000. There is no pro rata distribution of costs among the separate loans—all of the Grace Entities' attorneys fees associated with the global settlement are assessed against the Osborn Loan investors, and all payments to be made to the Grace Entities' creditors are to be assessed against the Osborn Loan investors and the Central & Monroe Loan investors. The Motion fails to provide any justification whatsoever for

[2] The Ninth Circuit's *Woodson* test was derived from the seminal Supreme Court decision articulating the factors as follows: "[T]he judge should form an educated estimate of the complexity, expense, and likely duration of such litigation, the possible difficulties in collecting on any judgment which might be obtained, and ***all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise***." *Protective Comm. for Indep. Stockholders v. Anderson*, 390 U.S. 414, 424 (1968) (emphasis added).

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apportioning this entire amount to the investors in the Osborn Loan and the Central & Monroe Loan.

Furthermore, ML Manager provides no basis for asserting that the payment of the total sum of $365,000 to Osborn and the total sum of $615,000 to Central & Monroe is reasonable, necessary, or proper. The Motion provides no information regarding these payments other than that "ML Manager believes based on representations" made by unidentified Grace Entities that $980,000 will be used to pay unidentified creditors of the Grace Entities. To the extent such funds are a necessary and reasonable component of this global settlement, such costs should be explained to the investors and to the Court, and should be allocated proportionately among the loans. Similarly, the asserted legal fees of the Grace Entities have not been specified with sufficient detail to allow the Court and parties to determine whether they are reasonable. Given this information vacuum, the Court and investors cannot determine whether the Motion is fair and equitable. Accordingly, the Motion should be denied.

WHEREFORE, based on all the foregoing, the Rev Op Investors respectfully request that the Court enter an order:

A. Denying the Motion;

B. Ordering ML Manager to adjudicate the agency authority issues in the Adversary Proceeding and to cease from attempting to have such issues determined on motion or other methods;

C. Granting to the Rev Op Investors such further relief as the Court deems appropriate.

DATED this 26th day of May, 2010.

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Exhibit A

Rev Op Investors

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Yuval Caine and Mirit Caine

Evertson Oil Company, Inc.

Ronald Kohner

Brett M. McFadden

Michael Johnson Investments II, L.L.C.

Pueblo Sereno Mobile Home Park L.L.C.

Queen Creek XVIII, L.L.C.

Morley Rosenfield, M.D. P.C. Restated Profit Sharing Plan

Trine Holdings, L.L.C.

William L. Hawkins Family L.L.P.

L.L.J. Investments, LLC, as successor in interest to Louis B. Murphey, the James C. Schneck Revocable Trust, and The Lonnie Joel Krueger Family Trust

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