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9 **IN THE UNITED STATES BANKRUPTCY COURT**
10 **FOR THE DISTRICT OF ARIZONA**

11 **In re:**

12 **MORTGAGES LTD., an Arizona corporation,**

13 **Debtor.**

In Proceedings Under Chapter 11
(converted from Chapter 7)

Case No. 2:08-bk-07465-PHX-RJH

PARTITIONING OWNERS’
OBJECTION TO ML MANAGER’S
MOTION TO SELL REAL
PROPERTY FREE AND CLEAR OF
LIENS, CLAIMS, ENCUMBRANCES,
AND INTERESTS

(Real Property located in Maricopa
County, AZ at 902 N. Signal Butte Rd.,
Mesa, AZ (“VCB Property”))

Hearing Date: May 27, 2010
Hearing Time: 10:00 a.m.
Location: Courtroom 603

14 The parties who bring this objection are all but one of those fractional interest owners
15 in the VCP Property who have initiated a partition action in the Maricopa County Superior
16 Court, Case No. CV2010-093413.¹ They will refer to themselves hereinafter as “the
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26 ¹ A true and correct copy of the Complaint in the partition action is attached hereto as Exhibit 1. The only one who is
27 not a part of this objection is Robert Furst, who filed his own Objection earlier today. These Objectors join in Mr.
28 Furst’s Objection also.

1 Partitioning Owners.” For the reasons they describe below in more detail, the Partitioning
2 Owners object to ML Manager’s proposed sale of the VCB Property.

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4 **I. PARTITIONING OWNERS ARE PURSUING THEIR**
5 **ABSOLUTE RIGHT UNDER ARIZONA STATUTE TO**
6 **PARTITION THEIR INTERESTS, AN ISSUE OVER WHICH**
7 **THIS COURT HAS NO JURISDICTION AND WHICH NO**
8 **ALLEGED AGENCY POWER OF ML MANAGER CAN**
9 **TRUMP.**

10 Partitioning Owners all elected not to transfer their fractional interests in the VCB
11 loan to the new post-confirmation entity now referred to as VCB Loan, LLC. The fractional
12 interests of the Partitioning Owners never were property of the Mortgages Ltd. bankruptcy
13 estate. Nothing has transpired before, during, or after confirmation of the Plan to transform
14 those interests. The Partitioning Owners have now asserted their absolute right under
15 Arizona statute² to have their respective rights in the VCB Property partitioned. This Court
16 can neither stop that process nor approve a sale of the VCB Property that would transfer
17 Partitioning Owners’ interests.

18 In its Motion to Sell Real Property Free and Clear of Liens, Claims, Encumbrances,
19 and Interests, ML Manager describes what it claims to be the jurisdictional power of this
20 Court to approve a sale of non-consenting co-owners like Partitioning Owners:

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22 ML Manager asserts that the Court has retained jurisdiction in the
23 Plan for such a matter as this, including sections 9.1(e), (g), and (h)
24 of the Plan among others, and has the authority to approve the sale
25 under Section 363(b) and (f) of the Bankruptcy Code and under
26 Section 105 of the Bankruptcy Code, among other sections, as an
order in aid of implementation of the Plan.

27 ² A.R.S. §12-1211, *et. seq.*

1 (ML Manager’s Motion, at p. 4) However, nowhere in any provision of the Plan, nor in
2 any portion of the Court’s confirmation order, has the Court reserved jurisdiction to
3 approve the sale of co-owners’ interest in any property. Moreover, 11 U.S.C. § 363 does
4 not apply following confirmation. *See, In re Golf, LLC*, 322 B. R. D. (Bankr., D. Neb.,
5 2004); *In re Western Integrated Networks, LLC*, 329 B.R. 334 (Bankr. D. Colo.,
6 2005)(finding that section 542 does not apply post-confirmation). Thus, this Court simply
7 does not have the jurisdictional authority to approve the sale of property that would involve
8 the sale of co-owners’ interests. Consequently, this Court cannot approve the proposed
9 sale of the entire VCB Property and cannot derail the effort of Partitioning Owners to
10 obtain a partition of their interests under Arizona state law in an Arizona Superior Court.

14 ML Manager invokes its alleged agency power to force Partitioning Owners to
15 accept the proposed transaction. However, even assuming without admitting the existence
16 of an agency power, the grant of agency power was not a transfer of ownership. It did not
17 divest Partitioning Owners of their property rights in their respective fractional interests. It
18 did not empower Mortgages Ltd. –and now, ML Manager – to step into the shoes of
19 Partitioning Owners and control every element of property ownership rights. The
20 Partitioning Owners retained their absolute and independent right to seek partition. ML
21 Manager cannot point to any provision in any alleged agency agreement that can trump the
22 absolute right of the Partitioning Owners to pursue partition under state law.
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II. THE ALLEGED AGENCY AGREEMENT DOES NOT EMPOWER ML MANAGER TO FORCE THE PARTICIPATING OWNERS TO SELL THEIR INTERESTS IN THE VCB PROPERTY.

ML Manager wields the alleged agency agreement against Partitioning Owners (and other so-called “NTIs”) like a righteous sword and shield. From the very early days of the Mortgages Ltd bankruptcy, however, the “investors” have challenged that agency power. This Court has never ruled on whether Mortgages Ltd. – and now ML Manager – can invoke that agreement to force former “investors” like the Partitioning Owners to sell their fractional interests against their will. Indeed, a recently as November 4, 2009, this Court stated the following:

The Court has made no determination as to whether the ML Manager has authority to sell the fractional interests of non-transferring investors. That issue has not been presented to the Court for decision, and it was simply an error for the Memorandum Decision to indicate that the ML Manager lacked authority to sell such fractional interests. But 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 actually arises and is properly presented to the Court for decision.

(Order Denying Sternberg and Rev Op Group’s Motions to Reconsider memorandum Decisions and orders of October 21 and 27, November 4, 2009, Docket # 2369, at p. 1)

Assuming without admitting that this Court has jurisdiction at all to consider the sale of the VCB Property, the agency issue is now before this Court. This Court cannot rule upon that issue without a significant evidentiary hearing. ML Manager’s Motion falls far short of the evidentiary basis the Court needs to decide the agency issue. When it does consider

1 all the evidence, the Court will have no alternative but to find that the agency agreement
2 does not allow ML Manager to force the Participating Owners to sell their fractional
3 interests in the VCB Property.³
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5 **A. As a Matter of Law, Any Agency Agreement By Which Mortgages**
6 **Ltd. Was Purporting to Act as Agent For “Investors” Terminated**
7 **Before Mortgages Ltd. Was Forced Into Bankruptcy.**

8 ML Manager seeks to act under a prepetition agency agreement that appointed
9 Mortgages Ltd. as the agent for the “investors” – including these Partitioning Owners.
10 However, that agreement terminated as a matter of law before Scott Coles took his own life
11 and before Mortgages Ltd. was ever forced into bankruptcy.
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13 If indeed there ever were a valid agency agreement, as agent for the investors like
14 the Partitioning Owners, Mortgages Ltd. owed its principals a “duty of utmost good faith,
15 integrity, honesty, and loyalty...” *See Musselman v. Southwest Realty, Inc.*, 147 Ariz. 173,
16 175, 704 P. 2d 814, 816 (1985). An agent who violates those duties forfeits that agency
17 power. Under black-letter principles of agency law, “[u]nless otherwise agreed, the
18 authority of an agent terminates if, without knowledge of the principal, he acquires adverse
19 interests or if he is otherwise guilty of a serious breach of loyalty to the principal.”
20 *Restatement (Second) Agency* § 112 (2010); *See, e.g., International Airport Centers, LLC*
21 *v. Citrin*, 440 F. 3d 418, 420, 421 (7th Cir. 2006); *NCMIC Finance Corporation v. Artino*,
22 638 F. Supp. 2d 1042, 1060 (S.D. Iowa, 2009); *Remenchik v. Whittington*, 757 S. W. 2d
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26 ³ Moreover, at least two of the Partitioning Owners – Bruce Buckley and John Vinson – withheld discretion in the first
27 place from Mortgages Ltd. Partitioning Owners will be prepared at the May 27, 2010 hearing to present a full summary
28 of all Participating Owners that have likewise withheld that discretion.

1 836, 839-840 (Tex. App. 1988); *Samia v. Central Oil Co. of Worcester*, 339 Mass. 101,
2 158 N.E. 2d 469, 477 (1959).

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4 From at least early 2007, Mortgages Ltd. violated with impunity every conceivable
5 duty of good faith, integrity, honesty, and loyalty owed to the so-called “investors,”
6 including the Partitioning Owners. The evidence showing the depth and malice of
7 Mortgages Ltd’s breach has only recently begun to surface. The facts are too voluminous
8 to catalog here. However, for purposes of this motion, and until this Court convenes an
9 evidentiary hearing on the agency issue, Partitioning Owners refer this Court to the
10 following four documents for a consideration of the evidence supporting their contention
11 that the agency agreement terminated as a matter of law long before Mortgages Ltd. was
12 ever forced into bankruptcy: (1) the class action complaint recently filed in the United
13 States District Court for the District of Arizona, Case no. 2:10-cv-01025 JWS (Exhibit 2
14 hereto); (2) the complaint filed by various investors, including most of the Partitioning
15 Owners, against the Estate of Scott Coles (Exhibit 3 hereto); (3) the complaint brought by
16 the Arizona Department of Financial Institutions against Mortgages Ltd. in March of 2009
17 (Exhibit 4 hereto); and (4) the Order Instituting Administrative Proceedings issued by the
18 Securities and Exchange Commission on January 19, 2010 (Exhibit 5 hereto).

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23 ML Manager now claims to be using the very uninterrupted agency power that Scott
24 Coles and Mortgages Ltd. used to deceive the investors. As a matter of law, there is no
25 such agency power. It ended before Mortgages Ltd was ever forced into bankruptcy.
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1 **B. Partitioning Owners Have Terminated Their Agency Agreements.**

2 To the extent any agreement still existed at the time Mortgages Ltd was forced into
3 bankruptcy, the Partitioning Owners have all expressly terminated their respective agency
4 agreements. (See Exhibits 6, 7, 8, and 9 hereto) Thus, without new and explicit
5 authorization, the ML Manager is without any authority to act on behalf of the Partitioning
6 Owners in any way, including carrying out the proposed sale of the entire VCB Property.⁴
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9 **C. Even if ML Manager Has Agency Power, It Must Exercise That**
10 **Fiduciary Power In A Manner Consistent With The Best Interests**
11 **Of Its Principals And Pursuant To The Principals' Instructions.**

12 Even assuming, without admitting, that an agency agreement exists allowing ML
13 Manager to force unwilling NTIs to sell their interests, ML Manager must exercise that
14 authority in a manner consistent with the best interests of its principals, including the
15 Partitioning Owners, and must act reasonably according to the instructions of the principal.
16 ML's track record in that regard is lacking. ML Manager previously made a motion
17 ("ASA Motion") similar to the one now before the Court, with the exception that the
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20 ⁴ The Partitioning Owners are aware that ML Manager has filed its *Verified Complaint for Declaratory Judgment on the*
21 *Enforceability of the Agency Agreements* in the instant case (the "Dec Relief Action"), and that certain
22 defendant/counterclaimants ("Rev Op Investors") in that Dec Relief Action have filed "Counterclaimant's Motion for
23 Partial Summary Judgment" ("Summary Judgment Motion") which Summary Judgment Motion requests a "judgment
24 that any Agency Authority that may have been held by ML Manager has been revoked". That Summary Judgment
25 Motion is set to be heard on May 26, 2010. ML Manager has filed its opposition (the "Opposition") to the Summary
26 Judgment Motion, and thereafter certain Rev-Op Investors filed their Reply (the "Reply"). The issues relating to the
27 termination/revocation of the Agency Authority of ML Manager as to certain of the Rev-Op investors have been
28 thoroughly briefed by the parties in that action and make clear that the Agency Authority is not an agency coupled with
an interest and therefore is terminable by the non-transferring investors. The Partitioning Owners hereby incorporate by
reference the Summary Judgment Motion and Reply for support of this proposition. The Partitioning Owners request
that the Court take judicial notice of such pleadings as the Court's own records are appropriate documents for judicial
notice. *United States v. Author Servs., Inc.*, 804 F.2d 1520, 1523 (9th Cir. 1986) ("It is well established that a court may
take judicial notice of its own records."), as amended, 811 F.2d 1264 (9th Cir. 1987); *Fed. R. Ev.* 201(b).

1 property in that motion was the so-called ASA Property. In the reply filed by ML Manager
2 (the “ASA Reply”), ML Manager summarily dismissed the objection filed by the various
3 investors (the “Oxford Investors”) and discarded any suggestion that the investors, despite
4 being the principals in the purported agency relationship, had any role whatsoever in the
5 determination of their fate. After acknowledging that the Oxford Investors had been
6 invited to participate in the hearing by ML Manager, ML Manager announced the
7 following:
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10 The 5 Non-transferring Pass-Through Investors who call themselves the
11 Oxford Investors mistake notice of a proceeding with the right to control or
12 vote. ***They have no right to instruct the Agent or to control the decision.***
13 Their objection to the sale and the request to delay is noted, but the Agent
14 in the exercise of its business judgment and in exercise of its discretion has
15 decided to proceed with the sale.

16 (See “Reply in Support of Motion to Sell Real Property Free and Clear of Liens, Claims,
17 Encumbrances, and Interests” in the ASA Loan matter, hearing date May 18, 2010, at page 5,
18 footnote 1) In making this candid statement, ML Manager flatly ignored its fiduciary duty to
19 its principals by evidencing only disdain for any input from the principal, and in doing so,
20 stood agency law on its head.

21 Early in this bankruptcy case, this Court reminded the parties of the overarching
22 fiduciary duties imposed on any entity purporting to act on behalf of the investor
23 principals. At the November 25, 2008 hearing regarding the debtor’s request for approval
24 of certain settlements related to the so-called University & Ash loan and the Roosevelt
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1 Gateway I and II loans⁵ this Court noted that the debtor’s authority was authority, such as
2 it was, was that “given in the agency agreement or subscription agreement”⁶ and the
3 Court observed the following:
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5 Those are my reasons why I believe the authority exists – existed and
6 continues to exist in the debtor in possession. I do agree, of course, it has
7 to be exercised with the interest of investors and creditors primarily in mind
8 because **there is also that fiduciary duty.**”

8 [Emphasis added](See Transcript at page 7, lines 5-9) The “fiduciary duty” identified by the
9 Court finds routine expression throughout the common law and the existence and nature of
10 that fiduciary duty are summarized in the Restatement (Third) of Agency (“*Restatement*”) as
11 follows (and in relevant part):
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13 Agency is the fiduciary relationship that arises when one person (a
14 "principal") manifests assent to another person (an "agent") that the agent
15 shall act on the principal's behalf and subject to the principal's control, and
16 the agent manifests assent or otherwise consents so to act...

17 An agent has a fiduciary duty to act loyally for the principal's benefit in all
18 matters connected with the agency relationship.

18 *Restatement, §§1.01, 8.01.*

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20 More particularly, the *Restatement* also dictates the following about the limits of an
21 agent’s duty:

22 ... (2) An agent has a duty to comply **with all lawful instructions received**
23 **from the principal** and persons designated by the principal concerning the
24 agent's actions on behalf of the principal...

25 _____
26 ⁵ See Transcript of University & Ash settlement hearing (“Transcript”) attached as Exhibit 10 hereto at page 4, lines 14-15.

27 ⁶ Precisely the authority in question in the Motion at bar.

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An agent acts with actual authority when, **at the time of taking action that has legal consequences for the principal**, the agent reasonably believes, in accordance with the principal's manifestations to the agent, **that the principal wishes the agent so to act...**

(1) An agent has actual authority to take action designated or implied in the principal's manifestations to the agent and acts necessary or incidental to achieving the principal's objectives, **as the agent reasonably understands the principal's manifestations and objectives when the agent determines how to act...**

(2) An agent's interpretation of the principal's manifestations is reasonable if it reflects any meaning known by the agent to be ascribed by the principal and, in the absence of any meaning known to the agent, as a reasonable person in the agent's position would interpret the manifestations in light of the context, including circumstances of which the agent has notice **and the agent's fiduciary duty to the principal...**

(Emphasis added)(See *Restatement*, §§ 2.01, 2.02, 8.09)

Thus, the *Restatement* makes clear that the fiduciary duties of an agent require: (i) the agent act subject to a “principal’s control” (§1.01), (ii) the agent has a “a fiduciary duty to act loyally for the principal's benefit in all matters connected with the agency relationship” (§8.01), (iii) the agent act in accordance with “all lawful instructions received from the principal (§8.09) “as the agent reasonably understands the principals manifestations” (§2.02) “at the time of taking action that has legal consequences for the principal” § 2.01. Therefore, to the extent the Court should find any subsisting agency authority at this time (which the Partitioning Owners dispute), the Partitioning Owners hereby explicitly instruct ML Manager to take no action on their behalf, or any one of them, that would cause the sale or any other transfer or disposition of the Partitioning Owners’ VCB Interest.

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III. CONCLUSION.

For these reasons, the Partitioning Owners object to the proposed sale of the VCB Property.

DATED this 26th day of May, 2010.

THOMAS SCHERN RICHARDSON, PLLC

By /s/ Richard R. Thomas
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ORIGINAL of the foregoing e-filed
this 26th day of May, 2010 with:

US Bankruptcy Court Clerk
electronically forwarding to all
parties to this action

/s/ Teresa Whitney