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IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re	Chapter 11
MORTGAGES LTD.,	Case No. 2:08-bk-07465-RJH
Debtor.	**REPLY IN SUPPORT OF MOTION TO SELL REAL PROPERTY FREE AND CLEAR OF LIENS, CLAIMS, ENCUMBRANCES, AND INTERESTS –VCB Loan** **Real Property located in Maricopa County, AZ located at 902 N. Signal Butte Rd., Mesa, Arizona** **Hearing Date: May 27, 2010** **Hearing Time: 10:00 a.m.**

ML Manager LLC ("ML Manager"), as manager for the VCB Loan LLC and the 7 MP Funds that are members of the VCB Loan LLC and as agent for the 17 pass-through investors who hold fractional interests but who did not transfer into the VCB Loan LLC ("Non-transferring pass-through investors"), hereby files this Reply in Support of its Motion to Sell Real Property Free and Clear of Liens, Claims, Encumbrances, and Interests, and asks that the Court enter an order authorizing and approving the sale as set forth in the Motion.[1] Mr. Thomas filed an objection on behalf of 14 Non-transferring

[1] ML Manager apologizes for the length of this Reply, but consistent with Mark Twain's sentiments, it did not have time to write a short one. The Responses were filed at noon the day before the hearing, which was at the same time ML Manager was preparing for and participating in the Rev-Op Motion on Partial Summary Judgment in a related matter.

pass-through investors (8 of whom are Oxford Partners investors who have appeared, objected to other matters and are on their 3rd attorney of record) and Mr. Furst also filed an objection (collectively, the "Objectors"). . Two of the Non-transferring pass-through investors have not objected or appeared. This Reply addresses both objections.

I. THE RESULTS OF THE LOAN LLC VOTE.

The VCB Loan LLC ("VCB Loan LLC"), which was formed in June 2009 pursuant to the confirmed Plan, owns 73.851% of the interest in the property. The members of the VCB Loan LLC include 7 of the 9 MP Funds (with hundreds of investors), Radical Bunny LLC and the pass-through investors who transferred into VCB Loan LLC. Only 26.149% of the interest is owned by the 17 Non-transferring pass-through investors, and only 24.351% is held by the Objectors. As the Court will recall, the operating agreement for the VCB Loan LLC required that Major Decisions (such as selling the property) must be voted on by the members of the limited liability company and the investors in the MP Funds and must be approved by a majority in dollars of those who vote. A vote has been conducted by the ML Manager of the members of the VCB Loan LLC and the MP Fund investors. Based on the voting results,[2] about 72% of the dollars which were voted approved the sale and 85% of the number of people voted to approve the sale. **In other words, about 72% of the dollars held by investors who voted in the VCB Loan LLC which owns about 74% of the property voted to sell the property for the price, to the buyer and at the time proposed by ML Manager**.

II. WAIVER BY THE EXIT FINANCIER.

One of the contingencies of the Sale Agreement and the Exit Financing Loan Agreement is that (as long as the loan is outstanding) the Exit Financier has the right to

[2] Six Ballots were received after the Noon deadline on May 26 from Honey Lou Reznick and her daughter, some of the largest holders of interests in the MP Funds. She and her daughter voted in favor of the Sale. If their votes are included, the favorable vote increases to 72.5% of the dollars voted. Since only a majority in dollars that voted is required for approval, the consideration of the late ballots is unnecessary.

compete for the purchase of any property sold. This provision was intended to ensure that the property will not be sold for too low a price. Immediately upon being informed of the sales price and provided with a copy of the Sale Agreement, the Exit Financier provided ML Manager with a written waiver of its right to compete.

III. EXERCISE OF VALID BUSINESS JUDGMENT.

ML Manager in the exercise of its business judgment has decided it is in the best interest of the investors in the loan to sell the property at this time for $1.616 million to Pinnacle Ridge Holdings LLC (an unrelated or unaffiliated entity) on the terms set forth in the Sale Agreement. The **buyer** will post $150,000 earnest money and the escrow has been set up at a local title company. The buyer has demonstrated that it has ample funds to purchase the Property. It is anticipated that if the Court enters the sale order that the sale will close by mid-July 2010. One of the requirements of the buyer was that ML Manager obtain the approval of the investors in the VCB Loan LLC and the Bankruptcy Court within 30 days of the signing of the Sale Agreement, which period expires June 22, 2010. Delay or continuance or even partition is not an option without losing the sale. This buyer is a homebuilder and is buying the property in bulk so that it will own the whole subdivision. It is paying $50,500 per lot.

ML Manager believes the price obtained is the current market price for the property, which consists of approximately 32 lots on 37 acres of real estate a subdivision named Adobe Meadows in Maricopa County, Arizona. ML Manager obtained a broker opinion of value from Grubb & Ellis in late 2009 from one of the leading brokers in the State, who is experienced with this kind of land and this area of the State. The broker estimated the likely value of the land at between $800,000 to $1,600,000. The sale price of $1.616 million obtained in this sale is higher than the highest range reflected in the Broker Opinion of Value. ML Manager did not believe it was necessary or good use of funds to obtain a formal appraisal of the Property. The price is all cash at the close of

escrow.

ML Manager employed a different **broker,** Nathan & Associates, to list and market the property. The broker marketed the property widely to buyers of this type of property and over the marketing period received and reviewed several offers for the property. ML Manager reviewed all the offers and accepted the highest offer from a buyer that it thought would close. The Sale Agreement used is the standard form agreement which is being used by ML Manager, and which in fact has been used on multiple occasions already. Nathan and Associates will receive a 3% commission upon closing.

As for **timing**, 11 months after the Effective Date of the Plan, which is a liquidation plan, only 5 loans have remained current. All other loans are in default. To date ML Manager has foreclosed on about 15 of the loans in the loan portfolio. Virtually all of the foreclosed properties are or have been listed for sale with a broker, including the largest one Tempe Land Company condo project which it foreclosed in April 2010. ML Manager has another 18 trustee sales on defaulted loans scheduled to take place this summer. By about mid-August 2010 (which is almost 14 months after the Plan become effective) it will have foreclosed on more than half of the loans. ML Manager has indicated to the investors in its newsletters that virtually all of the properties will be put up for sale after foreclosure so that the exit financing can be repaid and investors can receive distributions.

This property does not generate income to cover the expenses, such as taxes, insurance, interest expenses and other exit financing costs. It is the business judgment of the ML Manager that the price is unlikely to increase substantially in the foreseeable future and that if not sold these holding expenses will continue to burden the property and are not likely to be recoverable in the future. This sale if approved is anticipated to close by mid-July 2010 and will end such holding costs. Then as reflected in the Interborrower Agreement and Loan Agreement, 70% of the net sale proceeds will be paid to the Exit

Financier. The other 47 Loan LLCs and the Liquidating Trust will be obligated to repay VCB Loan LLC for their proportionate share of the Exit Financing (plus interest) as their properties are sold. VCB Loan LLC will receive interest on their funds that are being used to pay exit financing costs. It is anticipated that the investors will receive a distribution from this sale as well as upon subsequent sales as other Loan LLCs dispose of their properties.

While the Objectors have filed objections (as to price, timing, and the buyer, among other things), second guessing the business judgment of their Agent and seeking to end or delay or partition the sale and risking the termination of the Sale Agreement, the business judgment of the ML Manager is supported and buttressed, among other things, by the overwhelming vote of the investors in the VCB Loan LLC (who own 73.815% of the interest in the property) that agreed (by about 72% of the dollars voted and 85% of people voting) with the price, timing and buyer as recommended by the ML Manager.

IV. AGENT HAS SOLE DISCRETION ON SALE AS TO THE NON-TRANSFERRING PASS-THROUGH INVESTORS.

As the Court will recall, the ML Manager received an assignment of the irrevocable Agency Agreements which contains a power of attorney coupled with an interest and became the Agent for all the Pass-Through Investors. The Pass-Through Investors were given until October 31, 2009 to decide whether to transfer into the applicable Loan LLCs and receive a membership interest.

On this loan, 17 Pass-Through Investors decided not to transfer and as a result 26.149% is managed by ML Manager as the Agent while 73.851% is managed by ML Manager as the manager for the VCB Loan LLC. Only members of the VCB Loan LLC and the investors in the MP Funds in the Loan LLC are allowed to vote and to control the Major Decisions of ML Manager on the management of the property[3]. Pursuant to the

[3] The Non-transferring Pass-Through Investors have no right to instruct the Agent or to control the decision. Their objection to the sale and the request to delay or partition is

Agency Agreement, the Agent has sole discretion on the decisions to be made about the management of the property after foreclosure.

Paragraph 3(b) of the Agency Agreement states:

> If ownership of any Trust Property becomes vested in Participant, either in whole or in part, by trustee's sale, judicial foreclosure or otherwise, Agent may enter into one or more real estate broker's agreement on Participant's behalf for the sale of the applicable Trust Property, enter into a management and/or maintenance agreements for management or maintenance of the applicable Trust Property, if applicable, may acquire insurance for the applicable Trust Property, and may take such other actions and enter into such other agreements for the protection and sale of the applicable Trust Property, **all as Agent deems appropriate in its sole discretion.**

This sole discretion in the Agent remains necessary so that the property can be managed in a way to maximize the value for all the investors in the property and to ensure that no one investor could hold the others hostage. The vote of the Loan LLC investors was intended to be a check and balance of the discretion of the Agent/ Manager on Major Decisions. The Non-transferring Pass-Through investors chose to retain their interests under the existing Agency Agreements. Indeed, there was an objection asserted at the hearing for the confirmation of the Plan to any change or amendment to the Agency Agreements. Accordingly, paragraph U(1) of the Confirmation Order expressly removed from the operation of the Plan any ability to modify or change the terms of the Agency Agreements.

V. ML MANAGER HAS PROVIDED INFORMATION TO SUPPORT ITS BUSINESS JUDGMENT.

ML Manager has made the investors aware that it will market and attempt to sell virtually all of the properties after foreclosure. After all, the Plan contemplated that investors would be repaid their investments through collection of the loans, foreclosure

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noted, but the Agent in the exercise of its business judgment and in exercise of its discretion has decided to proceed with the sale.

and sale of properties and suits on guaranties. All of the investment programs originally offered to investors by Mortgages Ltd. were at best 1 year investments. The expectation under the Plan was that the properties and loans would all be collected or sold sometime in the next three to five years at most. We are now at the end of year one of the Plan implementation.

ML Manager has shared with Mr. Thomas, counsel for the 14 Non transferring pass through investors, information including the broker opinions, sales and marketing information was provided and copies of other offers were provided. Information about the taxes, insurance, and other expenses was also provided.

Contrary to the extreme characterizations in the Objections, ML Manager is not "fire selling" or selling for a "gross inadequate price" or at a "distressed price". It is being sold at the current market price. There is nothing unusual or nefarious about the ML Manager decision to sell at this time for this price to this Buyer. ML Manager is actively marketing several properties and expects to be in front of the Court seeking the approval of several Sale Agreements in the coming weeks and months and years. It is the considered business judgment of those given the authority to make the decision and that decision has been supported and buttressed by the vote of the members and investors in the VCB Loan LLC. As the Court will remember, the OIC chose the investors for the Board of Managers because of their experience and expertise. The Board is chaired by Elliott Pollack, who is a well known economist and real estate expert. Scott Summers is a senior vice president for a major lender in Arizona with experience in this real estate market and lending environment. Mark Winkleman, the chief operating officer, for ML Manager, is the former Arizona State Land Commissioner, who has sold billions of dollars of trust lands for the citizens of this State. The other two Board members David Fieler, an experienced business person with a finance background, and Bruce Etkin, an experienced real estate investor, add to the knowledge and expertise of the others. The

Board has had the benefit of working with experienced brokers familiar with the property and the market. The property has been exposed to the market place and an acceptable offer was negotiated and accepted from a buyer who has the ability and desire to close.

It is clear that delay is the real goal because the sale then goes away. The Objectors want this property to be held and sold later and think that partition is the best option. They argue that there is something wrong with being one of the first ones to be sold. This delay or partition will cause the Buyer to terminate the sale of all the lots. As long as the selling price is the current market price for the property, it should not matter when it is sold. In fact, those that sell first will have the portion of their proceeds used to repay the exit financing accrue and receive 17.5% interest on their funds which will be repaid out the sales of all of the other properties. This hardly seems a burden or hardship in today's environment. There are few places to put one's money in today's environment where one can receive that 17.5% return and it is uncertain whether this property if held would increase more than 17.5% in market value in any reasonable amount of time.

In any event, ML Manager in the exercise of its business judgment and in its sole discretion has decided to proceed with the sale as presented. The two other contingencies having been met – the accepting vote of the Loan LLC and the waiver by the Exit Financier—ML Manager requests that this Court enter the order requested so that the last contingency can be satisfied for the buyer and the title company.

VI. ATTEMPT TO PARTITION PROPERTY IS INSUFFICIENT BASIS TO DENY THE MOTION

Many of the Objectors apparently filed a lawsuit, on May 26, 2010, the day before the hearing on this Motion, in state court to partition the property. This lawsuit and the partition claim violate the Channeling Injunction in the Plan and the Agency Agreements, illegitimately usurps ML Manager's rights, and are futile. Moreover, a partition is not practical.

A. The Partition Action Violates the Channeling Injunction.

As the Court noted on the record at a hearing on May 26, 2010, this was essentially a liquidation plan. The Plan was premised on the common management and unified disposition of the property in an effort to maximize the value and minimize costs and provide the most return to the investors as soon as reasonable. To effectuate this goal, the Plan included a Channeling Injunction. Section 10.3 of the Plan provides:

> **Channeling of Claims.** The rights afforded under the Plan and the treatment of all Claims and Interests (including post-Effective Date Claims) as provided for in the Plan shall be the sole and exclusive remedy on account of all Claims and Equity Interests (including post-Effective Date Claims) of any nature whatsoever against the Debtor, the Reorganized Debtor, the Liquidating Trust, the ML Loans, and the Investors. **Any and all claims or causes of action asserted against such parties arising out of or related to the Plan, the Reorganized Debtor, Investors, or the Liquidating Trust or the Committees shall be commenced only in the Bankruptcy Court.** (emphasis added).

Paragraph J in the Order confirming the Plan further provided that this Court retained jurisdiction for the purposes provided in the Plan. The filing of the Partition Action in state court is a clear violation of the Channeling Injunction. For this reason alone the arguments with regard to the Partition claims should be rejected.

B. The Partition Action Violates the Agency Agreements.

This Court has already ruled that ML Manager's agency interest is coupled with an interest and is irrevocable by manifestation of termination by the investors. As noted above, the Agency Agreement provides that it is irrevocable and that the Agent has the sole discretion to sell the investor's interests and the property following a trustee's sale. Furthermore, Section 5(d) of the Agency Agreement provides:

> **Breach.** If Participant Breaches this Agreement by failing to perform **or by interfering with Agent's ability to perform under this Agreement**, then Participant shall pay Agent …any other fees or charges owed to Agent as compensation hereunder, along with any additional damages incurred by Agent, whether actual, incidental or consequential. (emphasis

added).

In other words, ML Manager, as the Agent, has the right, in its sole discretion, to sell the property in question and the investors cannot interfere.

There were no objections lodged by these investors during the confirmation of the Plan to the assignment of the Agency Agreements, or the fact that ML Manager would have the sole discretion to take these actions. As such, this Partition Action filed in violation of the Plan should not be grounds to deny the Motion.

C. <u>The Attempt to Divide the Property To Avoid a Sale is Futile.</u>

Under Arizona law, a property cannot be partitioned if there cannot be a "fair and equitable division of the property", if a fair partition of the property "cannot be made without depreciating the value thereof"or if there is "any reason a sale is more beneficial to the parties or any of them." A.R.S. § 12-1218. If any of those conditions exist, Arizona law requires that the Court order the property sold and the money divided instead of a partition. *Id.*

In this case, the property at issue consists of 37 acres and 32 finished lots of approximately 1 acre each, with existing streets and common areas, all subject to a final plat and CC&Rs for common development by a single developer. (A copy of the Final Plat, and CC&Rs will be available as evidence at the Hearing.) Not all of the lots are the same size and/or configuration. Further more not all the lots have identical values. Some are reduced for drainage easements, or are reduced to accommodate public roads and cul-de-sacs.

Apparently, 15 investors have joined the Partition Action. According to the allegations in the Partition Action Complaint (Exhibit 1 to the Objection), one investor owns a 3.901%, but all of the rest own between 0.563% to 1.95%. Even if the common areas, roads, and drainage easements are ignored and all of the lots were considered to be fungible (which obviously they are not because all real property is unique), none of the

lots match up with the percentage ownership of any of the investors. One lot out of 32 is 3.125%. Only one investor would be entitled to a single lot, but his interest does not match the proportionate value of one lot, and none of the other investors comes close.

Even if the interests of the 15 were combined so that their 24.351% collective interest is considered, there is no way to exactly match a specific number of the finished lots to the combined interest. Again, ignoring the issues of roads, common areas and drainage, the 24.351% is 7.79232% of the lots. In other words, there is no way to match the interests with a precise number of lots. This means a partition would require a court would be required to split the finished lots, which is impermissible under the final recorded plat and under the applicable zoning. Moreover, the entire concept that there will be multiple developers is inconsistent with the declarant rights in the CC&Rs. Indeed, it is not feasible to divide or split the declarant rights under the CC&Rs. It would destroy the common development schemes. In addition, as the lots are not uniform in size and very in terms of location, there is no effective way to partition the lots.

Moreover, the natural buyer is a homebuilder who wants all the lots. There are economies of scale and if there is a partition then it may make the rest of the subdivision unmarketable to a homebuilder. If partition were granted, a homebuilder such as this Buyer who wants the whole subdivision would not buy. This will diminish the value of the whole. The partition of lots to a non homebuilder would mean that empty lots could sit empty and could have inconsistent building quality and structures and make the rest of the subdivision undesirable and unmarketable.

There is also a drainage problem on all the subdivision that needs to addressed by all the lot owners. Also the subdivision will need landscaping. If there is separate ownership then it is less likely that the common problems would be addressed which would diminish the value of all the property. Simply stated, there is no even or fair way to partition the lots.

For these reasons, the Partition Action will inevitably lead to a court ordering the sale of the property, which is precisely what is being done at this time by ML Manager. Therefore, the Partition Action is futile and an insufficient reason to deny the Motion.

VII. THE WITHHOLDING DISCRETION DOES NOT AFFECT THE AGENCY GRANTED TO MANAGE THE LOANS.

Some of the investors raise allegations that they withheld discretion from Mortgages Ltd. when they executed their Subscription Agreements. This argument fails for three reasons.

A. The Court has Ruled on this Issue and its Ruling Is Law of the Case.

The withholding of discretion argument is the same argument that presented to the Court and litigated in connection with the University & Ash litigation. At that time, the Court rejected the argument and found:

> Indeed, it's [the argument about withholding discretion] kind of contrary to the very premise of some of the objectors that this was in fact a security under the Howey standards, because I believe most investors were investing in Mortgages' ability to manage these loans.

(See Transcript dated November 25, 2008, at p. 5.) The Court's decision that an investor's decision to withhold discretion did not affect the Agent's ability to manage the loan for the benefit of all the investors is the law of the case. "Under the 'law of the case' doctrine, a court is ordinarily precluded from reexamining an issue previously decided by the same court, or a higher court, in the same case." *Minidoka Irrigation Dist. v. DOI*, 406 F.3d 567, 573 (9th Cir. 2005)[4]; *Old Person v. Brown*, 312 F.3d 1036, 1039 (9th Cir. 2002). After the Court issued its ruling, the Plan to replace the Mortgages Ltd. as the agent was filed. For consistency sake, the ruling should not be altered.

[4] The law of the case doctrine is subject to three exceptions: "(1) the decision is clearly erroneous and its enforcement would work a manifest injustice, (2) intervening controlling authority makes reconsideration appropriate, or (3) substantially different evidence was adduced at a subsequent trial." Minidoka, 406 F.3d at 573 (rejecting each of the exceptions). None of those exceptions apply here.

B. <u>The Grant of Discretion Does Not Apply to the Agency Agreements.</u>

The Private Offering Memorandum ("POM") issued to every objecting investor expressly refers to two separate instances where Mortgages Ltd. may act as the agent for the investors. The POM first describes how the Subscription Agreement provides a grant of authority in the Subscription Agreement that allows the agent to select the investment or loan for the investor. (POM at p. 6). In addition, the POM next states that the Agency Agreement will be executed on behalf of the investors and the loans will be managed pursuant to the Agency Agreement. *Id*., at pp. 6, 8, 30. In making their argument, the objectors fails to distinguish between the two separate instances where agency was exercised.

Section 4 of the Subscription Agreements expressly states that the investor accepts and agrees to be bound by the Agency Agreement and the POM and Agency Agreements make it clear that the agency under that Agreement deals with the management of the Loans. This is the agency that ML Manager seeks to enforce. In contrast, additional provisions of the Subscription Agreement refer to the agency discussed in the POM with regard to the selection of the loan for the investment. It is this second instance of agency where the withholding of discretion applies.

The Subscription Agreements have a provision entitled "Grant of Discretion." This is the applicable provision with regard to this issue. It provides:

> **Grant of Discretion.** Until revoked at any time in writing, the undersigned hereby grants discretion to Mortgages Ltd., in its sole discretion, **to select for purchase and sale the Loan** or Loans with respect to which the undersigned acquires Participations. **Without limiting the foregoing,** the undersigned understands that **this grant of discretion** will give Mortgages Ltd. the authority, in its sole discretion, to make various determinations and take various actions with Loans **with respect to Participation to be acquired [] or sold by the undersigned**, including extending the terms of the Loans, modifying the payment terms of the Loans, accepting prepayments on the Loans, releasing a portion of the collateral securing the Loan, and otherwise dealing with

the Loans on behalf the undersigned. (emphasis added)

Following this provision, there is a place in some of the Subscription Agreements where the investor can indicate that "Discretion granted" or "Discretion withheld." ML Manager's position is that this provision is irrelevant to the agency conferred by the Agency Agreement because it only applies to the agency involved in selecting investments or Loans; a function that ML Manager is not performing. There are two separate reasons for the Court to confirm its prior ruling and determine that this provision does not apply to the Agency Agreements.

1. Applying the "Grant of Discretion" to the Agency Agreements Violates the Rules of Contract Construction.

The application of the grant of discretion provision to the Agency Agreements would render portions of the Subscription Agreements, the POM and the entire Agency Agreements inconsistent with each other, superfluous, and would eviscerate the entire structure of the investment where common management was central to the investment and therefore declared irrevocable. The law regarding construction of contracts is clear. The Court must adopt an interpretation that, wherever possible, harmonizes the various provisions of the documents, gives full effect to all separate provisions, does not render any provision superfluous, and does not allow the evisceration of parts of the contract. *Aztar Corp. v. U.S. Fire Ins. Co.*, 223 Ariz. 463, 476, ¶ 45, 224 P.3d 960, 973 (App. 2010) ("We interpret a contract 'so that every part is given effect, and each section of an agreement must be read in relation to each other to bring harmony, if possible, between all parts of the writing.' Our reading of one provision of a contract must not render a related provision meaningless.") *See also Chandler Medical Bldg. Partners v. Chandler Dental Group*, 175 Ariz. 273, 277, 855 P.2d 787, 791 (App. 1993) ("A contract must be construed so that every part is given effect, and each section of an agreement must be read in relation to each other to bring harmony, if possible, between all parts of the writing. As

a corollary, the court will not construe one provision in a contract so as to render another provision meaningless. The court must apply a standard of reasonableness in contract interpretation.") In this case, the only interpretation that meets all of these requirements of the law is the interpretation that the Grant of Discretion provision applies to the instance where agency could be granted to select the investment, but not to the agency granted by the Agency Agreements.

There are several significant points why such an interpretation limiting the Grant of Discretion to the agency to select an investment is the correct interpretation as a matter of law. Grammatically, this interpretation is required. The first sentence of the provision is clear. It "grants discretion to Mortgages Ltd., in its sole discretion, **to select for purchase and sale the Loan**." (emphasis added) Accordingly, the first sentence in the provision clearly provides that the agency at issue is for the selection the investment. More importantly, the next sentence, which contains the clause relied upon by the objectors, does not expand this "Grant of Discretion." The second sentence begins: "Without limiting the foregoing . . . this grant of discretion. . . ." As such, it is clear that this second sentence refers to the same grant of discretion as discussed in the first sentence, which relates solely to the agency to select the investment. This conclusion becomes inescapable when the critical prepositional phrase in the middle of the second sentence is considered. After describing the discretion that Mortgage Ltd may exercise, it states: "**with respect to Participation to be acquired [] or sold by the undersigned**, including . . ." (emphasis added), and lists the things that may be considered when exercising the agency. The Objectors rely solely on this last list of things to be considered. Significantly, however, this list is in the phrase that begins: "with respect to Participation to be acquired . . . including." As such, the list modifies the prepositional phrase immediately preceding the clause, which establishes that the scope of the discretion is in the selection of the investment. *See Phoenix Control Sys., Inc. v. Ins. Co. of N. Am.*, 165 Ariz. 31, 34, 796

P.2d 463, 466 (1990) ("The last antecedent rule is recognized in Arizona and requires that a qualifying phrase be applied to the word or phrase immediately preceding as long as there is no contrary intent indicated."). By applying the last antecedent rule to the phrase that begins "including," it is clear that the list is still with respect to the selection of investments. It does not modify the agency created several sections earlier from the adoption of the Agency Agreements.

Construing the "Grant of Discretion" paragraph to apply to the selection of the investment is also required because otherwise it would nullify many other provisions in the Agency Agreements. First, if applied to the Agency Agreements, the Grant of Discretion would eviscerate the numerous provisions where the Agency Agreements are declared irrevocable. Second, it would render meaningless the phrase in the second sentence of the Grant of Discretion: "with respect to Participation to be acquired [] or sold by the undersigned. . ." Finally, applying the Grant of Discretion to the Agency Agreements is inconsistent with the entire structure of the investment that depended on the common management of the loans.

2. Appling the "Grant of Discretion" to the Selection of the Investment Harmonizes the Agreements

In contrast to the inconsistency and contradictions created by applying the Grant of Discretion to the Agency Agreements, applying the provision solely to the agency involved with the selection of a loan or an investment harmonizes all of the various parts of the agreements. There is no question that there could be individual decisions and discretion exercised in selecting the investments or loans. These individual decisions do not impact the entire business model or interests of other investors nearly to the same extent as the management of a portfolio of loans in default, which is the current posture. In this situation, common management was a central feature of the Plan and is critical to its success. One investor's ability to essentially veto the actions taken on behalf of all

other investors, or one well-heeled investor who wants the ability to hold out for a better deal to the detriment of all other investors who cannot afford the carrying costs is untenable. That is the situation we are in now, and the reason why one investor cannot be given a veto ability to prohibit the Agent's ability to manage the Loans.

C. The Grant Of Discretion Is Inconsistent With Law Regarding An Agency Coupled With an Interest.

An additional reason that the Grant of Discretion provision cannot make the Agency Agreements revocable is that by operation of law, the agency is irrevocable. In practice, an agency coupled with an interest is generally made irrevocable by its own terms, but even if not specified in the agreement, it is deemed irrevocable by law. *Phoenix Title & Trust Co. v. Grimes*, 101 Ariz. 182, 184, 416 P.2d 979, 981 (1966) (citing *Hunt v. Rousmanier's Admin.*, 8 Wheat. 174, 203 (1823); Williston, Contracts §280, 3rd Ed.; 3 Am.Jur.2d Agency, §63; *McColgan v. Bank of California Nat. Ass'n.*, 208 Cal. 329, 335, 281 P.381, 383 (1929); *Lang Mortg. Co. v. Crenshaw*, 93 Cal. App. 411, 418, 269 P. 672, 679 (Cal. App. 1928). As the Court found in connection with the Rev-Op Motion for Partial Summary Judgment, as a matter of law, an agency such as the one at issue, cannot be revoked by the manifestation of the principal. Allowing an investor to revoke the agency under the "Grant of Discretion" provision is contrary to the operation of law with regard to an agency coupled with an interest or a power given as security.

VIII. THE ASSERTIONS OF BREACH OF FIDUCIARY DUTY DO NOT RESTRICT ML MANAGER'S EXERCISE OF ITS AGENCY RIGHTS.

Mr. Furst and the other objectors assert that ML Manager is breaching fiduciary duties to the objectors. Significantly, the objectors do not cite to any authority, nor could ML Manager find any authority for the proposition that a breach of fiduciary duty invalidates the action of an agent whose agency is coupled with an interest. Indeed, such an argument is inconsistent with the very notion of an irrevocable interest. At best, a claim that ML Manager has breached a fiduciary duty or has breached a contract would

give the investors a cause of action, but does not terminate the agency or invalidate the actions taken by the agent.

The nature of an irrevocable agency created by agency coupled with an interest was briefed and argued in connection with the Rev-Op Motion for Partial Summary Judgment. That briefing and those arguments are incorporated herein. As explained in that briefing, an agency coupled with an interest is fundamentally different than normal agency relationships. Indeed, The *Restatement (Third) of Agency*, (the "*Restatement*") notes that "a power coupled with an interest is an instance of a power given as security." Restatement 1.04 cmt. f. A power given as a security does not create a typical agency relationship as it places the agent and the principal in a potentially adverse relationship. *Id.* Consequently, an agent holding an irrevocable agency does not have standard fiduciary duties. *See, id.* This makes sense. If an agent is given the power to sell a person's house, for example, to secure a loan made to improve the property, there is an inherent conflict of interest between the rights of the agent and the rights of the principal. In this case, it may well be in the interest of the objecting investors for the agent to waive the provisions of the confirmed Plan that require ML Manager, as the agent to assess to the objectors "before distributions are made … their proportionate share of costs and expenses…". The fact that there is a conflict between the interests of these objectors and the vast majority of other investors in the VCB Loan who want to sell the property, or even between the interests of ML Manager does not terminate the agency or invalidate the actions taken under the Agency Agreements.

As the Court is aware, the Agency Agreements provide the agent sole discretion to take various actions. As noted above, these actions that were left to the sole discretion of the agent included the right to sell the property after title to the property was recovered through a trustee's sale. The only exception was if a single investor recovered title to the entire property. (Agency Agreement, at § 3(b)).

Moreover, the arguments that a breach of fiduciary duty incapacitates the agent from taking action was litigated in the University and Ash litigation. In the University and Ash Litigation, this Court rejected and overruled all the objections based on breach of fiduciary duty and ruled that the agent had the authority to enter into a settlement agreement with the borrower over the investors objections. The Court's decision is the law of the case. Again, for consistency sake, the ruling should not be altered.

Moreover, the objectors all consented to giving the agent sole discretion in these types of decisions when they entered into the agreements. Section 8.06(1) of the *Restatement*, states that "[c]onduct by an agent that would otherwise constitute a breach of duty . . . does not constitute a breach of duty if the principal consents to the conduct. Here, it is clear that the individual investors consented to agent's exercise of agency authority despite obvious potential conflicts of interest. First, as noted below the agency agreement gave Mortgages Ltd. the sole discretion to manage the Loans including the right to initiate a sale of the Loan Property. Second, in obtaining this consent, Mortgages Ltd. provided the individual investors, through the POM, with a description of the Agency Agreement as well as a full description of the rights and powers given to Mortgages Ltd. Accordingly, the individual investors consented to any conflict of interest relating to the sale of the property.

The individual investors irrevocably provided Mortgages Ltd. with their rights to manage the loans. This transfer of authority included the irrevocable right of Mortgages Ltd. to commence foreclosure of the Subject Property and initiate a sale of that property. Stated another way, by executing the Agency Agreement, the investors irrevocably waived any objection to Mortgages Ltd.'s reasonable exercise of its business judgment and any breach of fiduciary concerning a sale.

The case law makes it clear that in exercising its discretion it is unreasonable to require that ML Manager obtain the approval of each of the individual investors prior to

commencing foreclosure proceedings or initiating a sale of the Subject Property. This principle is eloquently stated in *Heine v. Newman, Tannenbaum, Helpern, Syracuse & Hirschtritt*, 856 F. Supp. 190 (S.D. N.Y. 1994), *aff'd*, 50 F.3d 2 (2d Cir. 1995), where the District Court rejected a principal's argument that an agent was required to obtain the principal's preapproval before acting. In noting that such a requirement would eviscerate the principles of agency law, the Court stated:

> If parties were required to verify with the principal each instruction given to them by an attorney-in-fact, the authority given to attorneys-in-fact would be eviscerated. No party to a transaction would rely on the statements of attorneys-in-fact without independent verification from the principal, and, accordingly, an attorney-in-fact would not be authorized to take any and all acts as fully as the principal. If a principal were permitted, at a future point in time, to decide that a particular instruction should have been verified, parties to a contract could not and would not be able to rely on the statements or instructions of attorneys-in-fact.

Id. at 195 (citations omitted). Here, the objectors are seeking to require that ML Manager obtain the independent prior approval of each of the individual investors prior to exercising its agency authority. The Objectors overlook the fact that they have already provided this authority to Mortgages Ltd. and that such a requirement would thwart the principles of agency law. The only thing that the law requires is that ML Manager exercise its reasonable business judgment in exercising is irrevocable agency. *See, e.g., Shoen v. Shoen*, 167 Ariz. 58, 65, 804 P.2d 787, 794 (App.1990) (noting that the business judgment rule precludes judicial inquiry into actions taken by agents and officers of a corporation in good faith and in the exercise of honest judgment in the legitimate and lawful furtherance of the purpose of the business or entity).

The bottom line is that a decision needs to be made with regard to the operation of this property, whether this is the appropriate time to sell, whether a sale now that reduces interest obligations on the exit financing that are running at 17.5% per annum and provides the investors in this loan with a return of 17.5% per annum is appropriate. The

applicable test is and should be the business judgment rule. There is no other parties benefiting at the objector's expense. The majority in this loan want to sell and have approved a sale. A sale of the entire parcel maximizes the value. Carving the parcel up into smaller pieces does not. Those are exactly the types of business decisions that must be left to the business judgment of the agent without second guessing by the Court. If there is a cognizable breach by the agent, the objectors have remedies at law. Those remedies do not include, however, the right to terminate the agency or vitiate the actions taken by the agent.

IX. THE ERISA ARGUMENT FAILS

Without any authority, Mr. Furst argues that the sale constitutes a "prohibited transaction" under ERISA. Mr. Furst is mistaken.

Mr. Furst selectively quotes from page 45 of the POM to imply that ML Manager must be a fiduciary for the Furst Plan, and therefore subject to ERISA's duties of "undivided loyalty" to the Plan. That description in the POM of ERISA fiduciary duties was prefaced by the following: "***If*** the Company is deemed to be a fiduciary [under ERISA], it would be subject to a much more strict standard of loyalty to Benefit Plans holding Participations than mere parties in interest." (emphasis added). There is no authority given for the assertion that Mortgages Ltd. or ML Manager ever became a fiduciary for an ERISA plan.

ML Manager is not a fiduciary of the Furst Plan (or any other Benefit Plan). It is not the sponsor or related to the sponsor of the plan, nor is it the trustee or related to the trustee. Further, the structure of the Participations prevents ML Manager from having the authority or control of Furst Plan's assets that might make ML Manager a fiduciary, as described at pages 46-47 of the POM. See ERISA § 3(21).

Moreover, this argument was never raised as part of the confirmation of the Plan or asserted as an objection as to the Plan. To the extent that Mr. Furst had an objection to

the Plan, he was required to bring them forth during the confirmation process and not wait until now.

X. CONCLUSION.

For the foregoing reasons, ML Manager requests that the Court enter an order as requested by the ML Manager in the Motion authorizing and approving the sale.

DATED: May 27, 2010

FENNEMORE CRAIG, P.C.

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