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16 IN THE UNITED STATES BANKRUPTCY COURT

17 FOR THE DISTRICT OF ARIZONA

19 In Re:
20 MORTGAGES LTD.,
21 Debtor.

Chapter 11 Proceedings

Case No. 2:08-bk-07465

**JOINT PRETRIAL STATEMENT RE
CONTESTED MATTER: APPROVAL
OF GRACE ENTITIES SETTLEMENT
AGREEMENT (Docket Item 2743)**

Hearing Date: July 7, 2010
Hearing Time: 10:00 a.m.

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26 The parties hereto, appearing by and through their counsel undersigned, hereby

1 submit their Joint Pretrial Statement regarding the instant contested matter as follows:

2 **I. NATURE OF THE CONTESTED MATTER:**

3 This contested matter arises from the Rev Op Group's objection to ML Manager's
4 Motion to Approve Settlements with Grace Entities. (the "Motion"). ML Manager filed
5 the Motion in its capacity as manager for six Loan LLCs and as agent for the non-
6 transferring pass-through investors who are fractional note and deed of trust holders in the
7 six Grace Entity loans. The six Loan LLCs are C&M Loan LLC; Osborn III Loan LLC;
8 PPP Loan LLC; 70 SP Loan LLC; 44 CP Loan I LLC; and 44 CP Loan LLC. The Grace
9 Entities filed a Joinder (Docket Entry 2762) to the Motion on May 26, 2010. The Rev Op
10 Group filed the Objection on May 26, 2010. No other parties objected to the Motion.

11 **II. UNCONTESTED FACTS DEEMED MATERIAL¹**

12 The parties agreed to the following uncontested facts:

13 1. The Grace Entities are a related group of five separate entities: Central &
14 Monroe, LLC; Osborn III Partners, LLC; Portales Place Property, LLC; 70th Street
15 Property, LLC and 44th and Camelback, LLC.

16 2. Mortgages Ltd. loan number 868606 is a loan that Mortgages Ltd. made to
17 Central & Monroe, LLC. The associated Loan LLC is C&M Loan LLC.

18 3. The collateral for this loan is a historic high rise building in downtown
19 Phoenix that was being renovated by the borrower into a hotel to be known as the "Hotel
20 Monroe." The address is 15 E. Monroe, Phoenix, Arizona.

21 4. ML Manager contends that the loan is in default and the principal owed is
22 \$27,313,178.50 plus accrued interest and fees.

23 5. The Grace Entities contend that Mortgages Ltd. defaulted by underfunding

24 _____
25 ¹ The facts set forth herein are uncontested purely for purposes of the settlements that are the
26 subject of the Motion. If the settlements are not approved by the Court and/or the other
conditions and contingencies are not satisfied, nothing in the Motion, this Pretrial Statement, or
the settlement agreements can or may be used against any party and nothing therein shall have
any admmissive or evidentiary effect.

1 the loan by more than \$40,000,000, therefore preventing the project from being completed
2 and giving rise to damages.

3 6. Central & Monroe filed a proof of claim by and through which it asserted
4 approximately \$110,266,000 of damages based upon the claims and causes of action
5 described in Exhibit A thereto.

6 7. ML Manager has disputed this allegation and disagrees with the alleged
7 claim amount.

8 8. Mortgages Ltd. loan number 851106 is a loan that Mortgages Ltd. made to
9 Osborn III Partners, LLC. The associated Loan LLC is Osborn III Loan LLC

10 9. The collateral for the loan is a 4-story luxury condominium project in
11 downtown Scottsdale.

12 10. The property is located west of Scottsdale Road on Osborn Rd., with a street
13 address of 7116 and 7126 E. Osborn Rd, Scottsdale, Arizona.

14 11. ML Manager contends that the loan is in default and the principal owed is
15 \$40,288,601 plus accrued interest and fees.

16 12. The Grace Entities contend that Mortgages Ltd. defaulted by failing to fully
17 and timely fund the loan.

18 13. Osborn III Partners, LLC filed a proof of claim by and through which it
19 asserted approximately \$25,400,000 in damages based upon the claims and causes of
20 action described in Exhibit A thereto.

21 14. ML Manager has disputed this allegation and disagrees with the alleged
22 claim amount.

23 15. Mortgages Ltd. loan number 852606 is a loan that Mortgages Ltd. made to
24 Portales Place Property, LLC. The associated Loan LLC is PPP Loan LLC.

25 16. The collateral for the loan is approximately 9.7 net acres of land directly
26 north of Scottsdale Fashion Square.

1 17. The property is zoned for condominiums with a condominium plat overlay
2 but no construction is underway.

3 18. ML Manager contends that the loan is in default and the principal owed is
4 \$32,000,000 plus accrued interest and fees.

5 19. The Grace Entities contend that Mortgages Ltd. defaulted by failing to fully
6 and timely fund the loan.

7 20. Portales Place Property, LLC filed a proof of claim by and through which it
8 asserted approximately \$24,400,000 in damages based upon the claims and causes of
9 action described in Exhibit A thereto.

10 21. ML Manager has disputed this allegation and disagrees with the alleged
11 claim amount.

12 22. Mortgages Ltd. loan number 861706, is a loan that Mortgages Ltd. made to
13 70th Street Property, LLC. The associated Loan LLC is 70 SP Loan LLC.

14 23. The collateral for the loan is an approximately 1.58-acre assemblage of
15 vacant land and residential acreage, located on 70th Street in downtown Scottsdale
16 between Goldwater Blvd. and Osborn Rd.

17 24. ML Manager contends that the loan is in default and the principal owed is
18 \$10,870,000 plus accrued interest and fees.

19 25. The Grace Entities contend that Mortgages Ltd. defaulted by failing to fully
20 and timely fund the loan.

21 26. 70th Street filed a proof of claim by and through which it asserted
22 approximately \$3,100,000 in damages based upon the claims and causes of action
23 described in Exhibit A thereto.

24 27. ML Manager has disputed this allegation and disagrees with the alleged
25 claim amount.

26 28. Mortgages Ltd. loan numbers 849606 and 852406 are loans that Mortgages

1 Ltd. made to 44th & Camelback Property, LLC. The associated Loan LLCs are 44 CP
2 Loan I LLC and 44 CP Loan II LLC.

3 29. The loans share the same collateral which is an assemblage of properties
4 consisting of approximately 3.03 acres of commercial and residential property located at
5 44th Street and Camelback in Phoenix, Arizona.

6 30. ML Manager contends that there is a senior lien in favor of Parkway Bank
7 for \$18 million on the properties. ML Manager also contends that prior to the bankruptcy
8 cases, Mortgages Ltd. entered into a Subordination Agreement with Parkway Bank which
9 granted Parkway Bank senior priority for its lien, and precluded Mortgages Ltd. from
10 foreclosing its interest in the property or taking any enforcement action without Parkway
11 Bank's consent.

12 31. ML Manager contends that, because of Parkway Bank's senior lien, there
13 may be no equity left to secure or pay the two junior loans held by 44 CP Loan I LLC and
14 44 CP Loan II LLC.

15 32. ML Manager contends that the loans are in default and that the principal due
16 on the loans, respectively, is \$5,828,477.31 and \$5,031,791.58, plus accrued interest and
17 fees.

18 33. The Grace Entities contend that Mortgages Ltd. defaulted by failing to fully
19 and timely fund the loan.

20 34. 44th & Camelback Property, LLC filed a proof of claim by and through
21 which it asserted approximately \$3,100,000 in damages based upon the claims and causes
22 of action described in Exhibit A thereto.

23 35. ML Manager has disputed this allegation and disagrees with the alleged
24 claim amount.

25 36. Limited guaranties were obtained by Mortgages Ltd. on each of the six
26 loans from Jonathon and Lori Vento, Donald and Shirley Zeleznak, and each of their

1 respective family trusts.

2 37. The guaranties are crossed between the loans and in some cases are limited
3 and capped in dollar amount.

4 38. Prior to the bankruptcy, a dispute had arisen between the Grace Entities and
5 Mortgages Ltd. arising out of, among other things, Mortgages Ltd's alleged failure to
6 timely and fully fund the loans to Osborn III Partners and Central & Monroe, LLC.

7 39. At the time of the bankruptcy, the loans to 70th Street Property, LLC,
8 Portales Place Property, LLC and 44th & Camelback Property, LLC had been fully
9 funded by Mortgages Ltd., although ML Manager and the Grace Entities dispute whether
10 that funding was timely and in accordance with the terms of the loan documents.

11 40. All five Grace Entities allege that Mortgages Ltd. engaged in conduct prior
12 to the bankruptcy cases that gave rise to significant damages.

13 41. Mortgages Ltd. disputed these allegations of failure to fund asserted by the
14 Grace Entities.

15 42. Osborn III Partners, LLC and Central & Monroe, LLC were two of the three
16 petitioning creditors of the involuntary Chapter 7 bankruptcy petitions that were filed on
17 June 20, 2008, commencing this bankruptcy case which Mortgages Ltd. converted to a
18 voluntary Chapter 11 case four days later on June 24, 2008.

19 43. As noted above, the Grace Entities filed five proofs of claim totaling
20 approximately \$167,816,000.

21 44. Objections to the claims were filed by the Official Committee of Investors
22 (the "Investors Committee").

23 45. The Grace Entities have taken the position that the six loans were part of a
24 common development scheme or business and that Mortgages Ltd. treated them as such.

25 46. Specifically, the Grace Entities have alleged that Mortgages Ltd. and its
26 former principal routinely took money out of impound accounts for one Grace Entity

1 project in order to fund draws on other Grace Entity projects, and conditioned Mortgages
2 Ltd.'s release of funding it was obligated to make on one Grace Entity project upon
3 receipt of payment from a different Grace Entity on its loan.

4 47. The Grace Entities also alleged that Mortgages Ltd.'s default and
5 underfunding of Central & Monroe, LLC's "Hotel Monroe" project and Osborn III
6 Partners, LLC's "Ten Wine Lofts" project, in particular, damaged the Grace Entities and
7 their principals' ability to develop and complete all of the projects.

8 48. For these and other reasons, they asserted substantial "lender liability"
9 claims against Mortgages Ltd., and took the position that the six loans and the five Grace
10 Entities were interrelated and inseparable from one another.

11 49. On the other hand, Mortgages Ltd., and ML Manager as its successor-in-
12 interest, dispute the Grace Entities' contentions in this regard.

13 50. Throughout Mortgages Ltd.'s bankruptcy case, with respect to the Grace
14 Entities, this was referred to as the "Bundling Issue."

15 51. The validity and priority of Mortgages Ltd.'s notes and deeds of trust, and
16 the validity of the Grace Entities' claims and defenses were not litigated during the
17 bankruptcy or determined as part of the Plan that was confirmed by the Bankruptcy Court
18 through the Plan Confirmation Order entered on May 20, 2009.

19 52. Prior to confirmation, the Grace Entities had objected to confirmation of the
20 Official Committee of Investors' First Amended Plan of Reorganization Dated March 12,
21 2009 (the "Plan").

22 53. Through negotiations with the Investors Committee the Grace Entities and
23 the Investors Committee agreed to the *process* of mediation (and if necessary, arbitration)
24 to resolve the competing claims.

25 54. The Grace Entities agreed to withdraw their objection to confirmation of the
26 Plan conditioned expressly upon the inclusion of Paragraph V in the Plan Confirmation

1 Order entered by the Court on May 20, 2009 (Docket Entry 1755) which set forth the
2 terms of the alternative dispute resolution through which the proposed settlements were
3 reached.

4 55. Paragraph V of the Confirmation Order defined the scope of the “Grace
5 Dispute” to be mediated by the Grace Entities and ML Manager as follows:

6 5. “Grace Dispute” means all Claims and Causes of
7 Action against ML held by one or more of the Grace Entities,
8 and all Claims and Causes of Action against the Grace
9 Entities and/or the Grace Guarantors held by ML or the ML
10 Investors, including but not limited to any and all Claims and
11 Causes of Action that have been or may be asserted by and
12 between the aforementioned parties, all Claims and Causes of
13 Action arising under the loan documents entered into by and
14 between ML and the Grace Entities, all guarantees in
15 connection therewith, all counterclaims in connection
16 therewith, any Claims or Causes of Action arising out of or
17 related in any way to ML’s failure to timely and fully fund its
18 loans to the Grace Entities, and all Claims and Causes of
19 Action arising out of ML’s conduct regarding these loans.

20 Plan Confirmation Order, ¶ V at 13:7-12.

21 56. Had the parties not agreed to a mediated settlement, the Plan Confirmation
22 Order obligated the parties to proceed to binding arbitration.

23 57. ML Manager asserts that, pursuant to the Plan Confirmation Order ML
24 Manager and representatives of the Grace Entities, along with their respective counsel,
25 participated in several mediation sessions, both collectively and separately, with Gary L.
26 Birnbaum, a well-respected real estate litigator with the law firm of Mariscal, Weeks,
Weeks, McIntyre & Friedlander, P.C.

58. ML Manager asserts that, in addition to those sessions, counsel for ML
Manager and the Grace Entities spent hours negotiating the terms contained in the
settlement agreements.

59. As part of these negotiations that formally began on August 26, 2009, the
Grace Entities and ML Manager reached a settlement on all six of the loans, as ultimately

1 documented in the five settlement agreements attached as Exhibit A to the Motion.

2 60. ML Manager asserts that, the Grace Entities represented to ML Manager
3 that other than the property securing the six loans, none of the entities, nor any of their
4 principals, had sufficient money or assets to satisfy any judgment that might be obtained
5 due to the Grace Entities' and their guarantors' alleged defaults on their loans and
6 guarantees.

7 61. The proposed settlements would resolve all of the six loans described above
8 in five separate settlement agreements, each of which becomes effective only if certain
9 Conditions Precedent occur. These Conditions Precedent are outlined in the settlement
10 agreements and must occur by July 31, 2010.

11 62. Under the settlements, ML Manager would conclude Trustee's Sales on four
12 properties as quickly as possible. These properties are currently owned by Central &
13 Monroe, LLC, Osborn III Partners, LLC, 70th Street Property and Portales Place Property,
14 LLC, respectively. Alternatively, ML Manager could request a deed-in-lieu of foreclosure
15 for the properties owned by 70th Street Property, LLC and Portales Place Property, LLC.

16 63. ML Manager asserts that Trustee's Sale dates have already been noticed by
17 ML Manager and will be continued from time to time until the Conditions Precedent have
18 been met and the settlement agreements have become effective.

19 64. The settlement of the two loans to 44th & Camelback Property, LLC is
20 different from the others for the reasons set forth below.

21 65. The settlement agreement on the two loans to 44th & Camelback Property,
22 LLC has the same Conditions Precedent to the effectiveness of the settlement agreement
23 on that property but is different from the other four settlements in that the two loans by
24 Mortgages Ltd. were and are subordinated to a senior loan by Parkway Bank ("Parkway
25 Loan").

26 66. ML Manager asserts that prior to the bankruptcy cases, Mortgages Ltd.

1 entered into a Subordination Agreement with Parkway Bank which granted Parkway Bank
2 senior priority for its lien, and precluded Mortgages Ltd. from foreclosing its interest in
3 the property or taking any enforcement action without Parkway Bank's consent.

4 67. Under the settlements, ML Manager would agreed that 44 CP Loan I LLC
5 and 44 CP Loan II LLC shall not request Parkway Bank's permission to foreclose those
6 two loans (since that would likely cause Parkway Bank to foreclose its loan), but instead
7 will remain in place behind the Parkway Loan, with all other rights under their loan
8 documents, and will wait to see if 44th & Camelback Property LLC can salvage the
9 project or is foreclosed out by Parkway Bank.

10 68. The settlements with Osborn III Partners, LLC and Central & Monroe, LLC
11 have an additional feature not present in the other three settlements.

12 69. ML Manager asserts that, Osborn III Partners, LLC and Central & Monroe,
13 LLC incurred substantial obligations to third parties in connection with their
14 developments, which they contend was a result of Mortgages Ltd.'s conduct and breach of
15 its obligations under the loan documents.

16 70. The settlement agreement with Osborn III Partners, LLC requires payment
17 upon any sale or refinancing of the property of the sums of \$510,000 to the Grace
18 Entities' counsel, Snell & Wilmer L.L.P., and an additional \$365,000 to Osborn III
19 Partners, LLC or its designee.

20 71. Similarly, the settlement agreement with Central & Monroe, LLC requires
21 payment upon any "Capital Event" (as defined in the settlement agreement) of three
22 separate sums in the amounts of \$230,000, \$260,000 and \$125,000 to Central & Monroe,
23 LLC or its designee(s).

24 72. A Capital Event is, generally, a sale or all or a portion of the property, a
25 refinancing of the property where any proceeds are to be distributed to the holders of CM
26 Loan LLC, or the admission of any new members in CM Loan LLC if any money is

1 contributed which is paid to the existing members of CM Loan LLC.

2 73. Each of the obligations on both properties would be evidenced by a
3 promissory note and secured by a single deed of trust on the associated property.

4 **III. CONTESTED FACTS DEEMED MATERIAL**

5 **A. Contested Facts Deemed Material by ML Manager:**

6 1. The principals of the Grace Entities are, among others, Jonathon Vento and
7 Donald Zeleznak.

8 2. The Central & Monroe Loan was a construction loan to refurbish the
9 building.

10 3. The building is not complete and there are alleged mechanics liens by
11 unpaid contractors, and suppliers.

12 4. The building subject to the Osborn III Loan is near completion and there
13 are alleged mechanics liens by unpaid contractors and suppliers.

14 5. With respect to the property securing the 70th Street Loan and 44th &
15 Camelback Loan, there are no known mechanics lien claims on the property.

16 6. The proposed settlements represent a compromise of the significant and
17 complex claims of both sides, reached only after months of negotiations with the
18 assistance of the mediator.

19 7. Assuming that the Conditions Precedent are met, the settlement agreements
20 will become effective and binding on all parties, including the non-transferring pass-
21 through investors.

22 8. Given the unlikely recovery against the Grace Entities and the Guarantors,
23 ML Manager believes that the settlements are in the best interest of the investors and are a
24 valid exercise of its business judgment.

25 9. ML Manager has evaluated the benefits and the detriments of the settlement
26 agreements. During this evaluation, ML Manager has had the independent evaluation of

1 an experienced mediator (who recommended the settlement) and has extensively
2 negotiated directly with the Grace Entities.

3 10. In evaluating the settlement agreement, ML Manager has considered, among
4 others, the following factors.

5 11. The settlement will allow ML Manager to obtain possession of the
6 properties (with the exception of 44th & Camelback, LLC's property) and obtain title
7 through consensual trustee's sales (or in the case of 70th Street Property, LLC and
8 Portales Place Property, LLC, deeds-in-lieu of foreclosure) so that the properties may be
9 resold to produce proceeds for investors, rather than pursuing actions against the Grace
10 Entities and/or the Guarantors, all of whom claim to be insolvent.

11 12. Proceeding against either the Borrowers or the Guarantors without the
12 proposed settlements would, in ML Manager's judgment, likely result in protracted,
13 expensive litigation and/or bankruptcies by the Grace Entities and/or the Guarantors,
14 which would likely tie up the properties for a substantial period of time.

15 13. ML Manager has considered the time and money already spent in discussing
16 and litigating with the Grace Entities, both prior to and during the Mortgages Ltd.
17 bankruptcy.

18 14. The dispute with the Grace Entities has lasted for over two and a half years.

19 15. ML Manager has considered the benefit of swift recovery of the four of
20 respective properties available under the settlement agreement.

21 16. Indeed, under the settlement agreements, the investors will obtain
22 immediate control of four of the respective properties.

23 17. Under the settlement agreement, the investors will preserve their liens with
24 respect to the 44th & Camelback property and not trigger a default of the subordination
25 agreement with Parkway.

26 18. ML Manager believes Parkway Bank is owed more money than the

1 properties securing its senior loan are worth, which effectively means there is no equity in
2 the collateral that secures the two loans Mortgages Ltd. made to 44th & Camelback
3 Property, LLC.

4 19. If Parkway Bank forecloses on the properties, there will likely be no
5 recovery for the holders of the two loans from 44th & Camelback Property because the
6 foreclosure will wipe out any junior liens. The Guarantors will only be released if
7 Parkway Bank forecloses or receives a deed-in-lieu of foreclosure and no bankruptcy of
8 the borrower is filed within 90 days of the foreclosure or receipt of the deed-in-lieu.

9 20. As indicated below, the Guarantors claim they are insolvent. If this is true,
10 no recovery can be obtained from them, so the release of the Guarantors after foreclosure
11 of the project by Parkway Bank and the passage of 91 days without a bankruptcy filing,
12 which was required by the Grace Entities in order to obtain a settlement on all matters,
13 will not result in any loss of a possible recovery by the holders of those loans.

14 21. ML Manager has considered the risk of loss to the investors as a result of
15 potential arbitration with the Grace Entities and determined that the settlement removes
16 the risk of loss from the investors.

17 22. According to the settlement agreements, mutual releases will be provided,
18 91 days after the trustee's sales or receipt of the deeds-in-lieu of foreclosure, assuming
19 that all conditions pertaining to the releases remain fulfilled.

20 23. Based upon the Guarantors' claim of insolvency, the only source of money
21 to repay the loans are the five properties at issue.

22 24. ML Manager however is verifying this the Guarantors' claims and
23 completing its review of their financial condition.

24 25. ML Manager has evaluated, or is in the process of evaluating, the financial
25 condition of the guarantors by reviewing financial statements provided by the guarantors
26 and retaining independent counsel to evaluate this information.

1 26. ML Manager has performed, or will perform, an examination of the
2 guarantors under oath to determine their financial condition and verify accuracy and
3 completeness of the guarantors' financial statements.

4 27. Based on the information obtained by ML Manager, ML Manager will
5 determine in its sole and absolute discretion if it is satisfied with the financial condition of
6 the guarantors.

7 28. If ML Manager is satisfied with the financial condition of the guarantors,
8 then ML Manager believes that exchanging the guaranties for immediate surrender of the
9 properties and release of claims and offsets asserted by the Grace Entities is in the best
10 interests of the investors.

11 29. ML Manager has also reviewed the claims asserted by each of the Grace
12 Entities.

13 30. Payment of \$615,000 from the future proceeds of the project to Central &
14 Monroe, LLC to obtain a release of an \$110,266,000 claim is reasonable in light of the
15 significant claims and set-offs asserted by Central & Monroe.

16 31. Payment of \$875,000 from the future proceeds of the project to Osborn III
17 Partners, LLC to obtain a release of a \$25,400,000 claim is reasonable is reasonable in
18 light of the significant claims and set-offs asserted by Osborn III.

19 32. ML Manager believes based on representations made by the Grace Entities
20 during the mediation that such amounts will be used to pay creditors of the Grace Entities
21 and their guarantors to stop them from pursuing the Grace Entities and the guarantors, and
22 potentially forcing them into bankruptcy, which would further delay ML Manager's
23 efforts to realize on the properties for the benefit of the investors.

24 33. These amounts are relatively small when compared to the amount of the
25 loans and the alleged damages.

26 34. These settlements are well within the range of what is reasonable and

1 equitable.

2 35. According to the Plan and the operating agreements of the respective Loan
3 LLCs, each of the affected Loan LLCs will have an opportunity to approve the
4 settlements. The balloting process for this approval will commence on July 1, 2010.

5 36. After approval by the respective Loan LLC's, ML Manager will be
6 authorized to consummate the settlements as manager of the Loan LLCs.

7 37. ML Manager has looked at these factors, among other things, and
8 determined that the settlements are in the best interest of the investors in each of the
9 respective loans and reflect a valid and reasonable exercise of ML Manager's business
10 judgment and are fair and equitable.

11 **B. Rev Op Group's Contested Material Facts:**

12 1. At various times prior to the commencement of this case, Mortgages Ltd.,
13 the debtor in the above-captioned bankruptcy case ("Debtor"), made loans to the Grace
14 Entities.

15 2. The Debtor sold all of its interests in each of the loans and in the
16 corresponding collateral securing such loans to various investors, who received fractional
17 interests in such loans and the corresponding loan collateral.

18 3. Various Rev Op Investors purchased fractional interests in certain of the
19 Grace Entity loans, including the Central & Monroe Loan and the Osborn Loan.

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

24 5. On May 20, 2009, the Court entered its Order Confirming Investors
25 Committee's First Amended Plan of Reorganization Dated March 12, 2009, thereby
26 approving the Plan as modified therein.

1 6. Thereafter, all the fractional interests of “opt-in” transferring investors were
2 transferred to the respective Loan LLCs. In particular, all of the applicable opt-in
3 investors’ fractional interests in the loans to the Grace Entities were transferred to one of
4 six respective Loan LLCs formed to hold interests related to the respective Grace Entity
5 loans.

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

9 8. ML Manager, as manager for the six Loan LLCs that hold interests in the
10 Grace Entity loans, has entered into a total of five separate settlement agreements with the
11 respective Grace Entities that purport to resolve all legal issues between the Grace Entities
12 (and related guarantors) and all parties holding fractional interests in the loans to the
13 Grace Entities.

14 9. ML Manager asserts that it has the power to bind the Rev Op Investors to
15 the proposed settlements by virtue of its asserted agency authority.

16 10. The Rev Op Investors dispute ML Manager’s asserted agency authority.

17 11. ML Manager commenced an adversary proceeding, Adv. No. 2:10-ap-
18 00430-RJH consolidated with Adv. No. 2:10-ap-00717-RJH (the “Adversary
19 Proceeding”), for a declaratory judgment regarding the nature, extent, and validity of its
20 asserted agency authority. The Adversary Proceeding is currently pending.

21 12. The Rev Op Investors dispute that ML Manger has authority to bind the Rev
22 Op Investors to the settlements. The Rev Op Investors contend that the agency authority
23 issues must be resolved in the Adversary Proceeding, and that the pendency of the
24 Adversary Proceeding precludes the Court’s consideration of such issues in the context of
25 the Motion.²

26 ² It is also the Rev Op Group’s position that to the extent the Motion is approved, nothing herein
2327315

1 13. In order to reach a settlement of these lender liability-type claims, ML
2 Manager has agreed to permit a \$1,490,000 to be paid to some of the Grace Entities'
3 creditors out of the proceeds of Central & Monroe, LLC's and Osborn III Partners, LLC's
4 real property collateral when those properties are sold after foreclosure.

5 14. To the extent ML Manager prevails on a credit bid at a trustee sale on
6 Central & Monroe, LLC's and Osborn III Partners, LLC's real property collateral on
7 behalf of the applicable Loan LLCs and purportedly on behalf of non-transferring
8 investors, the real property would be pledged to secure promissory notes in favor of one or
9 more Grace Entities or their designees.

10 15. Each of the obligations on both properties would be evidenced by a
11 promissory note and secured by a single deed of trust on the associated property, which at
12 that time would be owned by the applicable Loan LLC and non-transferring investors as
13 tenants in common.

14 16. The Rev Op Investors incorporate by reference their positions set forth in
15 Section IV.

16 **IV. CONTESTED ISSUES OF FACT AND LAW:**

17 **A. ML Manager's Position**

18 1. It is ML Manager's position that the only issue to be decided at trial is
19 whether ML Manager's decision to enter into the settlements with the Grace Entities is a
20 valid exercise of ML Manager's business judgment. It is ML Manager's position that
21 entering into the settlements was a reasonable exercise of business judgment because of
22 the factors set forth in Section III, *supra*, among other things.

23
24
25 shall affect the Adversary Proceeding (defined above) or other pending matters regarding the
26 asserted agency authority of ML Manager, and the Rev Op Investors reserve all applicable rights.
ML Manager, the Grace Entities, and the Rev Op Investors reserve all of their arguments and
positions.

1 **B. Grace Entities' Position**

2 1. It is the Grace Entities' position that the principal issue to be decided at trial
3 is whether ML Manager's decision to enter into the settlements with the Grace Entities is
4 a proper exercise of ML Manager's business judgment.

5 2. It is the Grace Entities' position that the Court has authority to grant the
6 motion and authorize ML Manager to take all actions contemplated in the settlement
7 agreements pursuant to Paragraph V of the Plan Confirmation Order, without impacting
8 any agency authority issues that may be pending in the adversary proceeding between ML
9 Manager and the Rev Op Group.

10 **C. Rev Op Group's Position**

11 The Rev Op Investors submit that resolution of the Motion presents at least three
12 issues, as follows:

13 1. The Court may not rule on the Motion while the agency authority issues are
14 pending in the Adversary Proceeding. The Rev Op Investors dispute ML Manager's
15 alleged authority to bind the Rev Op Investors to the proposed settlements, to sell the
16 collateral securing their fractional interests without their consent, to encumber their real
17 property with deeds of trust in favor of the Grace Entities or others, and to force them to
18 transfer their valuable ownership interests in the relevant loans and collateral. ML
19 Manager entered into the settlements after it commenced the Adversary Proceeding, with
20 full knowledge that its asserted agency authority was subject to material dispute. These
21 issues are squarely before the Court in the Adversary Proceeding and must be resolved
22 therein. The Court may not rule on the Motion, as such ruling requires a determination of
23 the agency authority issues.

24 2. The proposed settlements are precluded because they exceed the scope of
25 ML Manager's asserted agency authority, even assuming *arguendo* that it exists and that
26 the Court may consider agency issues (both of which the Rev Op Investors dispute). ML

1 Manager seeks to bind the Rev Op Investors to the settlements, which would require the
2 encumbrance of the Rev Op Investors' owned real property. The Court has already ruled
3 that ML Manager does not have authority to encumber or pledge the assets of the Rev Op
4 Investors. To the extent the collateral for the Osborn Loan and Central & Monroe Loan
5 are taken by credit bid at the trustee sales, they will be owned by the Loan LLCs and non-
6 transferring pass-through investors, as tenants in common. Pursuant to the settlements,
7 the Rev Op Investors' owned real property would be encumbered with a deed of trust to
8 secure repayment on one or more promissory notes in favor of the Grace Entities. This
9 arrangement exceeds even ML Manager's asserted agency authority. ML Manager has
10 never identified any document or alleged agreement that granted ML Manager agency
11 authority to encumber foreclosed property with loans to third parties, and indeed, no such
12 document exists. Moreover, the Court has already ruled that ML Manager may not
13 encumber or pledge the collateral or owned assets of the Rev Op Investors.

14 3. ML Manager's decision to enter into the five settlement agreements with the
15 Grace Entities is not a reasonable exercise of its business judgment, consistent with its
16 fiduciary obligations to the Rev Op Investors. ML Manager seeks to surcharge the
17 collateral of investors who hold fractional interests in the Osborn Loan and the Central &
18 Monroe Loan for all of the costs associated with the settlement, a total sum of \$1,490,000.
19 The settlement agreements are conditioned on many contingencies yet to be fulfilled and,
20 without which, the Court and interested parties cannot evaluate the propriety of the
21 proposed settlements. Incurring substantial attorneys' fees on an evidentiary hearing, for
22 example, is inconsistent with ML Manager's fiduciary obligations, when ML Manager has
23 not yet obtained a forensic accountant's evaluation regarding insolvency of the guarantors
24 and borrowers, has not yet held a vote of the Loan LLCs, and has not yet verified the other
25 contingencies that would render court approval moot. Furthermore, ML Manager must
26 establish how the allocation of the costs of the settlements to Osborn and Central &

1 Monroe is in the best interests of investors in those loans, as compared to the remaining
2 three loans, which do not pay the costs of the settlement.

3 Although the Grace Entities allege that Osborn and Central & Monroe have the
4 only significant lender-liability claims, the interdependence of the settlement agreements
5 holds the other three loans hostage unless the investors in the Osborn Loan and the
6 Central & Monroe Loan are surcharged nearly \$1.5 million. Thus, the settlements
7 presuppose that the Grace Entities have a strong likelihood of prevailing under their
8 “bundling” theory. The Grace Entities and ML Manager have failed to establish that the
9 bundling theory has any merit. If apportioning substantially all of the costs of the
10 settlement to Osborn and Central & Monroe is fair and proper, then there is no reason to
11 make the settlements for the other loans dependent upon approval of the Osborn Loan and
12 Central & Monroe Loan. The Motion provides virtually no information sufficient for the
13 Court to determine whether the settlement agreements are in the best interest of investors,
14 consistent with ML Manager’s fiduciary obligations. The settlement agreements as a
15 whole are not fair and equitable and cannot be approved.

16 **V. LIST OF WITNESSES TO BE USED BY EACH PARTY:**

17 **A. ML Manager Witnesses**

- 18 1. Mark Winkleman
- 19 2. Sarah Lisa Petrauschke
- 20 3. Any witness listed by any other party

21 **B. Rev Op Group’s Witnesses**

- 22 1. Louis Murphey
- 23 2. William H. Hawkins
- 24 3. Any witnesses called by any other party

25 **VI. EACH PARTIES ESTIMATION OF TIME REQUIRED FOR TRIAL:**

- 26 1. ML Manager estimates 1-2 hours are required for trial.

1 2. The Rev Op Group estimates 2- 8 hours are required.

2 **VII. TRIAL EXHIBITS:**

3 All parties reserve all objections to the various exhibits listed. Some of ML
4 Manager's exhibits may contain confidential or sensitive information and should be
5 redacted or used under seal.

6 **A. ML Manager's Trial Exhibits**

- 7 1. Central & Monroe, LLC's Settlement Agreement;
- 8 2. Osborn III Partners, LLC's Settlement Agreement;
- 9 3. Portales Place Property, LLC's Settlement Agreement;
- 10 4. 70th Street Property, LLC's Settlement Agreement;
- 11 5. 44th & Camelback Property, LLC's Settlement Agreement;
- 12 6. Petition for Involuntary Bankruptcy;
- 13 7. Proofs of Claim filed by the Grace Entities;
- 14 8. Amended Proofs of Claim filed by the Grace Entities;
- 15 9. Confirmed Plan of Reorganization;
- 16 10. Plan Confirmation Order;
- 17 11. Disclosure Statement to First Amended Plan of Reorganization, with
18 exhibits;
- 19 12. Grace Entities' Motion for Appointment of Interim Trustee;
- 20 13. Reply In Support of the Motion for Appointment of Interim Trustee
- 21 14. Grace Entities' Objection to the Plan;
- 22 15. Loan Documents;
- 23 16. Transcript of May 12, 2009 p.m. Hearing (Docket Number 2546);
- 24 17. ML Manager requests that the Court take judicial notice of the pleadings
25 included in the record;
- 26 18. ML Manager continues to assert that the only issue relevant to this trial is

1 whether or not the settlements were a valid exercise of ML Manager's reasonable business
2 judgment. To the extent that this trial encompasses larger issues, ML Manager reserves
3 the right to utilize additional exhibits, including but not limited to the agency agreements,
4 subscription agreements and other documents executed by the Objectors.

5 19. Any other exhibits use by any other party at trial;

6 20. Any other exhibits revealed in the course of discovery.³

7 **B. Objectors Exhibits**

8 1. ML Manager's Response to the Rev Op Group's First Set of Requests for
9 Production of Documents;

10 2. Memorandum Decision dated October 21, 2009;

11 3. Order Denying Sternberg and Rev Op Group's Motion to Reconsider
12 Memorandum Decision and Orders of October 21 and October 27;

13 4. Complaint and filings of record in Case No. Adv. No. 2:10-ap-00430-RJH,
14 as consolidated with Adv. No. 2:10-ap-00717-RJH;

15 5. Any other exhibits use by any other party at trial;

16 6. Any other exhibits revealed in the course of discovery.⁴

17 **VIII. CERTIFICATION OF THE PARTIES RE EXHIBITS**

18 All parties hereto certify that all listed exhibits have been exchanged or made
19 available to all other parties for inspection and copying.

20
21
22
23 ³ The Rev Op Group received the initial draft of a Joint Pretrial Statement on June 23, 2010.
24 They received a follow-up draft on June 29, 2010. The follow-up draft was substantially similar
to the initial draft.

25 ⁴ Counsel for the Rev Op Investors received ML Manager's *Response to the Rev Op Group's*
26 *First Set of Requests for Production of Documents* this date, June 30, 2010, and has not had time
to review the responses of ML Manager nor the produced documents. Counsel received the draft
of this Joint Pretrial Statement yesterday, June 29, 2010. Thus, the Rev Op Investors reserve the
right to supplement their list of exhibits as necessary to adequately present its case at trial.

