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10 IN THE UNITED STATES BANKRUPTCY COURT
11 FOR THE DISTRICT OF ARIZONA

12 In re
13 MORTGAGES LTD.,
14 Debtor.

Chapter 11

Case No. 2-08-BK-07465-RJH

**ML MANAGER'S RESPONSE TO
MORTGAGES LTD 401(K) PLAN'S
APPLICATION FOR ORDER TO SHOW
CAUSE AGAINST THE LIQUIDATING
TRUSTEE**

Hearing Date: July 15, 2010

Hearing Time: 1:30 p.m.

16 ML Manager LLC ("ML Manager") hereby files its Response to Mortgages Ltd.
17 401(k) Plan's Application For An Order To Show Cause ("Application") against the
18 Liquidating Trustee and requests that it be denied. ML Manager asserts that the two loan
19 impound accounts in question are loan impound accounts set up under the Loan
20 Documents for the two loans in question. The loan impound accounts were originally
21 FBO accounts under the Agent's control for the borrower and under the Loan Documents
22 after foreclosure are under the control of the Agent for the benefit of the investors in the
23 loans for the protection of the property, payment of taxes, expenses and costs, among
24 other things. Liquidating Trustee has no interest in those loan impound accounts nor to
25 the best of ML Manager's understand does the Liquidating Trustee claim an interest in the
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1 loan impound accounts.¹

2 ML Manager believes that it is the Agent under the Agency Agreements for the
3 Pass-Through Investors in both loans (including the 401(k) Plan) and that the loan
4 impound accounts are under its control. There is a disagreement currently between the
5 401(k) Plan and ML Manager over the enforceability of the Agency Agreement and the
6 ability of the ML Manager under Paragraph U of the Confirmation Order dated May 20,
7 2009 and the terms of the Agency Agreement to chargeback and allocate expenses and
8 costs of the bankruptcy and the exit financing to the 401(k) Plan as a Pass-Through
9 Investor that did not transfer its interests into Loan LLCs. The 401(k) Plan holds about
10 \$22 million of interests in loans out of the approximate \$900 million loan portfolio. It is
11 undisputed that the 401(k) Plan received the Private Offering Memorandum and signed
12 the Subscription Agreement incorporating the Agency Agreement and is a Pass-Through
13 Investor. As stated above, there is a disagreement of the effect and the consequence of the
14 documents. This disagreement will need to be decided with the filing of an adversary
15 proceeding if the parties do not reach an agreement. Over the past few months ML
16 Manager has talked with, met with, exchanged case law and exchanged documents with
17 the counsel for the 401(k) Plan in order to resolve the disagreement. ML Manager has
18 proposed that if the 401(k) Plan is concerned about ML Manager and/or the Liquidating
19 Trust holding the loan impound accounts that any loan impound accounts in dispute can
20 be placed with an escrow company and held until the disagreement is resolved by
21 settlement or court order. The 401(k) Plan evidently did not like this idea and instead
22 chose to file this Application against the Liquidating Trustee. However the Application is

23 ¹ The loan impound accounts originally were set up at the bank in the name of Mortgages Ltd.
24 FBO the specific borrower. On the Effective Date the loan impound accounts should have been
25 changed over to ML Manager FBO the specific borrower but were not. ML Servicing which is the
26 successor to Mortgages Ltd. continued to hold the funds in the same accounts and did not change
the name on the accounts to the ML Manager. Nonetheless, to the best of ML Manager's
information, ML Servicing and its parent the Liquidating Trust do not claim an interest in the
loan impound accounts.

1 not the place, time or procedure for such an order requiring the payment of the loan
2 impound accounts on these two loans to the 401(k) Plan. Consequently, ML Manager
3 requests that the Court deny the Application.

4 To reinforce this point, the Court has already stated in the prior Stipulated Order of
5 the Court from September 23, 2009 (Docket No. 2206) as follows:

6 (v) the Liquidating Trustee shall turn over to the current
7 trustees of the 401(k) Plan all books, records and other
8 documents and information belonging solely to the 401(k)
9 Plan; provided however that ML Manager LLC shall
10 continued to maintain possession and control of the original
11 ML Loan Documents for all the ML Loans and REO in which
12 the 401(k) Plan and the Pass-Through Investors, the MP
13 Funds and/or the Loan LLCs jointly have an ownership
14 interest. **To the extent the 401(k) Plan is responsible to
15 reimburse ML Manager LLC, the Liquidating Trust
16 and/or ML Servicing Co. for any expenses and costs,
17 nothing in this Order shall relieve the 401(k) Plan from
18 such responsibility.** As to such jointly owned ML Loans and
19 REO, the ML Manager LLC and/or Liquidating Trustee shall
20 make available to the 401(k) Plan copies of all such
21 documents and information upon written request of the
22 401(k) Plan which costs for copies shall be paid by the 401(k)
23 Plan.

16 On information and belief, the Liquidating Trustee did turn over to the current trustees of
17 the 401(k) Plan “all books, records and other documents and information belonging solely
18 to the 401(k) Plan”. On information and belief, the Liquidating Trustee also turned over
19 the check book for the 401(k) Plan bank account to the current trustees, thus satisfying the
20 requirements of the Order and what was requested in the Motion. Contrary to the
21 allegations of the 401(k) Plan, the Liquidating Trustee was not ordered to turn over the
22 loan impound accounts for these two loans to the 401(k) Plan. The only accounts
23 mentioned in the 401(k) Plan’s Motion To Ratify 401(k) Plan Appointments and Define
24 the Liquidating Trustee’s Role With Respect to the 401(k) Plan (Docket No. 2115)
25 addressed the 401(k) Plan’s “check book and bank account”. The original Motion did not
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1 address or mention the loan impound accounts set up for the loans. So the Order could not
2 have contemplated them.

3 As a result, in its Application the 401(k) Plan has improperly charged the
4 Liquidating Trustee, utilized the wrong procedure, and has omitted or misstated numerous
5 relevant facts and legal issues. Accordingly, ML Manager requests that this Court deny
6 401(k) Plan's application.

7 **1. There is a disagreement between the 401(k) Plan and ML Manager about**
8 **the Loan Impound Accounts on these two loans.**

9 In May 2009, the Court confirmed a plan of reorganization (the "Plan"). The Plan
10 transferred the agency agreements from Mortgages Ltd. to ML Manager and created
11 individual Loan LLCs to hold certain interests in the Loans. The Plan also provided some
12 investors an option of transferring their interests in loans into the respective Loan LLC.
13 The 401(k) Plan did not have an option to transfer its interests into a Loan LLC because of
14 the ERISA laws. However, ML Manager was assigned the Agency Agreement and
15 Subscription Agreement signed by the 401(k) Plan and considers the 401(k) Plan to be a
16 Pass-Through Investor like all other Non-Transferring Pass-Through Investors for its \$22
17 million of loans in the approximate \$900 million loan portfolio. ML Manager was
18 permitted to allocate the expenses of the bankruptcy equally upon all Investors, whether or
19 not they transferred their interests into respective Loan LLCs. Specifically, this Court's
20 Confirmation Order stated that each of the investors would be assessed their fair and
21 equitable share of expenses and reads:

22 Before such distributions are made, Pass-Through Investors
23 who retain their fractional interests in the ML Loans shall be
24 assessed their proportionate share of costs and expenses of
25 serving and collecting the ML Loans in a fair, equitable and
nondiscriminatory manner and shall be reimbursed in the same
manner as the other Investors.

26 (Docket No. 1755).

1 In September 2009, the 401(k) Plan and the Liquidating Trustee submitted a
2 Stipulated Order to this Court regarding the management of the 401(k) Plan, not the
3 management of the loans. In relevant part, this Order states:

4 (v) the Liquidating Trustee shall turn over to the current
5 trustees of the 401(k) Plan all books, records and other
6 documents and information belonging solely to the 401(k)
7 Plan; provided however that ML Manager LLC shall
8 continued to maintain possession and control of the original
9 ML Loan Documents for all the ML Loans and REO in which
10 the 401(k) Plan and the Pass-Through Investors, the MP
11 Funds and/or the Loan LLCs jointly have an ownership
12 interest. To the extent the 401(k) Plan is responsible to
reimburse ML Manager LLC, the Liquidating Trust and/or
ML Servicing Co. for any expenses and costs, nothing in this
Order shall relieve the 401(k) Plan from such responsibility.
As to such jointly owned ML Loans and REO, the ML
Manager LLC and/or Liquidating Trustee shall make
available to the 401(k) Plan copies of all such documents and
information upon written request of the 401(k) Plan which
costs for copies shall be paid by the 401(k) Plan.

13 (Docket No. 2206) The Order did not contain any language requiring the Liquidating
14 Trust to turn over the loan impound accounts in question to the 401(k) Plan.

15 **2. The 401(k) Plan has needlessly brought in the Liquidating Trust when**
16 **it knew its disagreement was with the ML Manager.**

17 In its Application, the 401(k) Plan named the wrong party. The 401(k) Plan is
18 requesting relief against the Liquidating Trustee. The alleged basis for this relief is that
19 the Liquidating Trustee is refusing to hand over the loan impound accounts for these two
20 loans which they allege belong to the 401(k) Plan. This is a straw man argument and is
21 improper against the Liquidating Trustee. The 401(k) Plan is fully aware that the
22 Liquidating Trustee does not claim any interest in the loan impound accounts. Instead, the
23 401(k) Plan is fully aware that its dispute is with the ML Manager. The 401(k) Plan's
24 Application makes no mention of ML Manager's interest in the loan impound accounts,
25 despite the 401(k) Plan's knowledge of ML Manager's asserted interest. Indeed, in
26 requesting distribution of the loan impound accounts, the 401(k) Plan has been negotiating

1 with and dealing with the ML Manager and not the Liquidating Trustee.

2 ML Manager's interest arises out of paragraph U of this Court's order confirming a
3 plan of reorganization for Mortgages Ltd. (the "Plan"). Paragraph U permits ML
4 Manager to allocate a proportional share of costs on non-transferring pass-through
5 investors. This ability to allocate funds is based on ML Manager's authority as Agent for
6 the investors, including the 401(k) Plan. Thus, ML Manager has an interest in allocating a
7 fair percentage of the costs of the bankruptcy to the 401(k) Plan. As this Court is aware,
8 ML Manager is currently in the process of finalizing the allocation. ML Manager is
9 working with an accountant to prepare and apply a model for the process that will be
10 applied to each loan as money is available to distribute, and is working with counsel on
11 the documents and requirements to ensure that this assessment and allocation is applied
12 across the board to all loans on a fair, equitable, proportional and non-discriminatory
13 manner to all investors.

14 **3. The 401(k) Plan has inappropriately used the Application for Order to**
15 **Show Cause procedure in order to apply pressure to the Liquidating Trustee when it**
16 **knew its disagreement was with ML Manager.**

17 The 401(k) Plan has also utilized the wrong procedure. The Application to show
18 cause is procedurally improper because it was not brought as part of a separate adversary
19 proceeding according to the Federal Rules of Bankruptcy Procedure. Instead the
20 Application seeks to recovery money from the Liquidating Trust on its own merits.
21 According to Rule 7001 "a proceeding to recover money or property" must be brought as
22 an adversary proceeding. Fed. R. Bank. P. 7001; *In re Wheeler Tech.*, 139 B.R. 235, 239
23 (B.A.P. 9th Cir. 1992) ("Rule 7001 requires an action to recover property to be brought as
24 an adversary proceeding."). Thus, a motion seeking to turn over property must be
25 commenced with an adversary complaint. *Id.* ("A turnover action is an adversary
26 proceeding which must be commenced by a properly filed and served complaint.")

1 (quoting *In re Perkins*, 902 F.2d 1254, 1258 (7th Cir. 1990)) (additional citations
2 omitted).

3 Here, the Application to show cause is an improper attempt to recover the loan
4 impound funds from the Liquidating Trust when he was never ordered to turn over the
5 loan impound accounts and in which he does not claim an interest. Such procedural
6 inadequacies are improper.² Accordingly, this Application should not be heard as a
7 contested matter under Rule 9014, but as a separate adversary proceedings with all of the
8 protections associated with that proceeding. This would provide all parties who have an
9 interest in the loan impound funds to present their claims with all of the procedural
10 protections of the Federal Rules of Bankruptcy Procedure.

11 **4. The 401(k) Plan has neglected to inform the Court of ML Manager's**
12 **Interest and Disagreement.**

13 Additionally, the 401(k) Plan has neglected to inform the Court of relevant
14 information as it relates to the 401(k) Plan's interest in the loan impound accounts and the
15 dispute with ML Manager. Primarily, as indicated above, the 401(k) Plan did not mention
16 that it first was dealing with the ML Manager. Indeed, the 401(k) Plan has withheld any
17 reference to ML Manager's asserted interest in the loan impound accounts. Additionally,
18 the 401(k) Plan omitted any reference to its liability to ML Manager for costs and
19 expenses related to the management of the loans and the bankruptcy. Moreover, the
20 401(k) Plan withheld all references to the irrevocable agency agreement it has signed.
21 Under normal circumstances, such omissions may be viewed as mere oversights.
22 However, due to the specific posture of these claims, including the effect that these
23 omissions have on ML Manager's claims, it appears that the 401(k) Plan's omissions were

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25 ² The Court may recall that earlier this year, ML Manager filed an application for an order
26 to show cause along with a declaratory judgment action as a separate adversary. This
Court rejected ML Manager's request and quashed the order to show cause. Here, the
401(k) Plan's procedure is less sufficient than that previously rejected by the Court.

1 calculated efforts to mislead this Court and to pressure the Liquidating Trustee.

2 In sum, the Application for an Order to Show Cause is procedurally improper. The
3 issues in dispute can only be resolved in a separate adversary, and cannot be resolved
4 through an Application For an Order to Show Cause. Additionally, the Application has
5 been brought against the Liquidating Trustee when the 401(k) Plan was well aware of ML
6 Manager's interest in the loan impound accounts. The 401(k) Plan has also withheld
7 relevant facts from this Court's consideration of this issue. Accordingly, ML Manager
8 requests that this Court deny the Application for an Order to Show Cause.³

9 DATED this 8th day of July, 2010.

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FENNEMORE CRAIG, P.C.

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By /s/ Cathy L. Reece (#005932)

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Cathy L. Reece

Keith L. Hendricks

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14 Copy of the foregoing was served
by email this 8th day of July, 2010 on:

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³ Interestingly, the 401(k) Plan has not yet received an order to show cause, but only a hearing on whether the Application should be grant and whether such an order is appropriate. ML Manager asserts that no hearing is necessary due to the procedural and substantive irregularity accompanying the 401(k) Plan's request and the Application should be denied.

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