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IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re MORTGAGES LTD., Debtor.	Chapter 11 Case No. 2:08-bk-07465-RJH **ML MANAGER'S SUPPLEMENTAL RESPONSE TO ROBERT FURST'S MOTION FOR ENTRY OF ORDER CONFIRMING THAT ALL INVESTORS IN THE GP PROPERTIES LOAN ORIGINATED BY THE MORTGAGES LTD. 401(K) PLAN HAVE TERMINATED THEIR AGENCY AGREEMENTS WITH ML MANAGER,** **Or, in the Alternative,** **MOTION TO STRIKE NEW ARGUMENTS MADE IN REPLY** **Hearing Date: August 2, 2010** **Hearing Time: 11:00 a.m.**

The original three-page motion (Docket 2716), filed by Robert G. Furst ("Furst"), raised a single issue – that the investors in the loan to GP Property (the "GP Loan") had terminated their Agency Agreement with ML Manager by unanimous vote. In his eleven-page Reply (Docket 2831), Furst raises for the first time many new issues or arguments, and introduces new evidence. This is procedurally improper because it deprives ML Manager of the chance to respond. Moreover, the factual predicate that Furst provides for his new arguments is, at best, incomplete and his legal conclusions are simply wrong. The Court should strike as procedurally improper all the new issues, arguments and evidence

presented for the first time in Furst's Reply. Alternatively, the Court should consider ML Manager's response to the new issues.

I. NEW ISSUES AND EVIDENCE PRESENTED IN A REPLY ARE PROCEDRUALLY IMPROPER

The law is clear. It is not proper to introduce new issues and evidence presented for the first time in a reply brief. *See, e.g., Koerner v. Grigas*, 328 F.3d 1039, 1048 (9th Cir. 2003) (issues not presented in an opening brief are waived); *Coos County v. Kempthorne*, 531 F.3d 792, 812 n.16 (9th Cir. 2008) (declining to consider an argument raised for the first time in a reply brief); *United States v. W.R. Grace*, 504 F.3d 745, 766 (9th Cir. 2007) (refusing to consider documents submitted with a reply brief); *Zamani v. Carnes*, 491 F.3d 990, 997 (9th Cir. 2007) ("The district court need not consider arguments raised for the first time in a reply brief."); *Taylor v. Hosseinpour-Esfahani (In re Hosseinpour-Esfahani*, 198 B.R. 574, 580 (B.A.P. 9th Cir. Cal. 1996) ("[R]eply briefs are not an appropriate forum for raising issues or new arguments). As such, the Court should not consider and should strike all the new issues, arguments and evidence asserted for the first time in the Reply. This is particularly true where, as here, Furst is bringing the Motion and asserting arguments on behalf of other investors even though he does not represent them, and can only represent his own interest.

II. ML MANAGER HAS AN AGENCY COUPLED WITH AN INTEREST

One of the most significant new arguments advanced in Furst's Reply is his assertion that ML Manager does not have an agency coupled with an interest in connection with the Agency Agreement as it relates to the GP Loan. This new argument is crafted on an incomplete, if not misleading recitation of new factual allegations in the Reply. Moreover, there is no evidentiary support for many of the factual allegations. Most important, Furst's legal conclusion that ML Manager does not have an agency coupled with an interest is simply wrong.

As the Court will recall from the extensive briefing and argument in connection with this issue in the Adversary Proceeding No. 2:10-ap-00430-RJH (the "Hawkins Adversary") associated with this case, the Court resolved the issue of whether ML Manager had an agency coupled with an interest with regard to the management of certain other loans. That analysis applies equally here.

In the Hawkins Adversary, the Court was faced with the question of whether Mortgages Ltd., the Debtor, had an agency coupled with an interest with regard to the "Agency Agreement" that was attached as Exhibit 20 the Verified Complaint in the Hawkins Adversary.[1] The agency created by the Agency Agreement allowed the Debtor to manage loans on behalf of its investors (the "Loan Management Agency"). It was argued that neither the Debtor nor ML Manager had an ownership interest in the Loans, and therefore the Loan Management Agency was not an agency coupled with an interest. However, following extensive briefing and argument, the Court found that the Debtor and ML Manager both had an interest in, at least, certain rights associated with the loans in question such as the right to the "interest spread" and default interest.[2] Accordingly, the Court found that ML Manager did have an agency coupled with an interest, and that the agency held by ML Manager was irrevocable. (A Copy of the Court's Ruling in the Hawkins' Adversary is attached as Exhibit A.)

Even if the ruling in the Hawkins Adversary is not *res judicata* here because there are different parties, it is the "law of the case". More important, its reasoning is persuasive and correct. Just as in the Hawkins Adversary, ML Manager has an interest in the GP Loan. ML Manager incorporates by reference all of its arguments as to what constitutes an agency coupled with an interest or a power given as security as asserted in

[1] This is the same form of the Agency Agreement that Furst is attempting to terminate through this Motion.

[2] This ruling in the Hawkins Adversary was consistent with several prior rulings made by the Court prior to the confirmation of the Plan of Reorganization for the Debtor, including the rulings arising out the University & Ash litigation.

the Hawkins Adversary. ML Manager notes that it has the right to, at least, the "interest spread" and "default interest" with regard to the investor's interest in the GP Loan.

Without citation to any evidence or factual support, Furst argues that the Debtor and ML Manager never had a right to any compensation from the GP Loan. Based on the documents, this is simply not true, and is based on an incomplete description of how the investors obtained their interests in the GP Loan.

It is true that the 401(k) Plan closed the loan with GP Properties on July 18, 2007. (*See* Exhibit B, GP Promissory Note)[3] The Note to the 401(k) Plan provided that the borrower pay $4.55 million plus interest at 12.25% per annum. Significantly, simultaneously with the closing of the Loan, the 401(k) Plan immediately assigned, through, among other things, a Promissory Note Indorsement, most of the rights in the GP Loan to the Debtor, MP 15, and another investor.[4] (*See* Exhibit C). The 401(k) Plan initially kept only 43.956% of the GP Loan.[5] **The 401(k) assigned <u>41.874%</u> of the loan to the Debtor**, 1.099% to MP 15, and 13.071% to three affiliated entities of another investor (Panagiotakopoulos). (*See id.*) With regard to the share assigned to the Debtor, the share that is primarily at issue in this Motion, **the 401(k) Plan assigned to the Debtor the entire 12.25% accrued interest** rate to be earned on its share of the Note. Significantly, the same was not true for the MP Fund and Panagiotakopoulos. They only got 10% of the interest, leaving a 2.25% interest spread. (*Id.*) In other words, the assignments clearly implicated the "interest spread" that has been discussed so much in the course of this bankruptcy and reorganization.

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[3] Significantly, the Loan was all documented on Mortgages Ltd.'s forms, using Mortgages Ltd.'s business model. It is likely that Mortgages, Ltd., not the 401(k) Plan arranged for and documented the Loan.

[4] Through the course of the investment, at least three separate MP Funds had an interest in the GP Loan. Ultimately, all of the MP Funds interests were assigned, however, to one or more individual investors.

[5] Through the course of the investment, the 401(k) Plan reacquired a few more percentage points in the loan from various investors.

After receiving its 41.874% share of the GP Loan with the right to the full amount of interest, the Debtor began conveying its interest in the loan to various investors. (*See* Exhibit D). In all, the Debtor assigned interests to over 20 other investors and MP Funds.[6] **Significantly, however, in every case the Debtor assigned less than the full 12.25% interest it was entitled to receive. (*Id.*)** The interest spread the Debtor retained was between 3.25% and 0.25%. There is no question that the net effect of all the assignments was that the Debtor still retained a portion of the interest spread. (*Id.*)

Moreover, it is undisputed that all of the investors, including the 401(k) Plan had Subscription Agreements and Agency Agreements with the Debtor, issued pursuant to the Private Offering Memorandum (the "POM"). These documents all provide that the Debtor is entitled to keep the default interest, which in this case is the difference between 27% and 12.25%. (See Agency Agreement at § 1(c)(3); POM, at p. 8)[7]

In the Hawkins Adversary, this Court already ruled that the Plan of Reorganization confirmed in this matter, as modified by the Confirmation Order dated May 18, 2009, allowed ML Manager the right to use, among other things, the interest spread and default interest for as long as it needed to for the payment of costs. (*See* Plan at, § 4.12). As such, ML Manager has an interest in, at least, the interest spread or the default interest. (*See* Exhibit A, at ¶ ¶ 65-70)

For the exact same reasons as stated in the ruling in the Hawkins Adversary, because ML Manager continues to have an interest in, at least, the interest spread or default interest, its agency under the Loan Management Agency is coupled with an interest and is therefore irrevocable. (*See id. See also* Briefing on ML Manager's Motion for Judgment on the Pleadings from the Hawkins Adversary, which is incorporated

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[6] There were several further assignments between investors, and the MP Funds ultimately assigned their interests to other investors.

[7] The Court can take judicial notice of these documents as they were filed in the Hawkins Adversary, as Exhibits 20 and 1 to the Verified Complaint, respectively.

herein.) As such, the question of whether all of the investors, or just some of them want to terminate the Loan Management Agency is irrelevant since the agency is irrevocable.

III. NOT SUFFICIENT EVIDENCE OF UNANIMOUS TERMINATION

In addition to the fact that the agency is irrevocable, Furst's argument fails because he failed to substantiate his claims with evidence. Furst asserts, without sufficient evidentiary support, that all of the investors in the GP Loan have terminated the Agency Agreements. As noted in the Response, Furst does not represent any other investor. Moreover, ML Manager is assuming that Furst is relying, to some extent, on letters written by Oxford Partners with regard to some of their clients. There is no evidence that Oxford Partners has a valid power of attorney or agency agreement that would allow them to act in this regard for their clients.[8]

IV. THE INVESTOR'S INTEREST IN THE GP LOAN IS SUBJECT TO THE PLAN

Furst asserts several new arguments that the investors are not responsible for the costs and expenses incurred by the Debtor or ML Manager. ML Manager understands that all investors would like to avoid, if they could, the costs associated with the bankruptcy. Significantly, however, Furst admits that he and the other GP Loan investors were subject to the Agency Agreement. Because the Debtor had sold the most of the ownership interests in the loans at issue to investors, the primary issue in the bankruptcy was the reorganization of the Debtor's rights as an agent. In this regard, the GP Loan investors are no different that any other investor and the fundamental question is whether they must pay their fair share to resolve the entanglement of their agent's bankruptcy like

[8] Furst attaches an email from Cathy Reece that was written before ML Manager was even formed. The fact that Fennemore Craig represented the Official Investors Committee and later represented ML Manager does not make the two separate entities fungible. They are not. Not only is the evidence procedurally improper because it was presented in a Reply, it is legally irrelevant. ML Manager has never renounced its rights under the Agency Agreements.

any other investor, and this includes the 401(k).[9]

One of Furst's new arguments is that the GP Loan investors should not be required to pay their fair share of the exit financing and other costs because the 401(k) Plan originated the loan. This argument is based on nothing more than semantics.

Furst acquired his interest in the GP Loan from Mortgages Ltd., through the POM, Subscription Agreement and Agency Agreement just like every other investor in this case. He did not acquire his interest in the GP Loans through the 401(k) Plan. As shown above, when the Debtor sold Furst his interest in the GP Loan, or when Furst made his investment, the Debtor retained the right to keep 2.125% of all the regular interest and all default interest above 12.25%, as well as a number of other fees. (*See* Exhibit D, at p. ML-GP0007)

Furst's economic situation in this investment is indistinguishable from the investment made by any other investor in any other loan in this case. To adopt Furst's argument that the GP Loan is not one of the "ML Loans" because it was originated by an entity other than the Debtor is to place form over substance and begin to draw lines based on semantics. The key analysis is how the investor acquired its interest and what obligations it owes to the Debtor; not how the Debtor acquired the interest in the loan. Looking at it another way, if the Debtor did not sell its interest in the GP Loan to Furst and kept that interest in its own name, it could have sued the borrower to recover its fractional interest in the loan. Accordingly, there is no question that the Debtor owned for its own benefit a substantial interest in the GP Loan before it accepted Furst's investment and the investments of the other investors. Moreover, the Debtor did not just sell its

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[9] The issue of whether the 401(k) Plan is liable for a share of costs is currently being briefed pursuant to an Order of the Court. The issue will be resolved at a hearing on September 21, 2010. Furst does not represent the 401(k) Plan, and he lacks standing to assert arguments on their behalf. The new arguments that Furst makes on behalf of the 401(k) Plan should be stricken for the same reasons that his prior pleading asserts claims for the 401(k) Plan was stricken.

interest to Furst and the others and then walked-away. Instead, it created the common investment scheme with the central management of this and every other loan for the common benefit of all investors. Furst simply cannot separate the agency relationship from the investment because the loan was already closed before the Debtor acquired its interest. When the Debtor sold its interest in the GP Loan to Furst, just like when it sold an interest in any other loan to any other investor, it did so as part of the common investment scheme, which was accompanied with an irrevocable Agency Agreement. Furst's investment in the GP Loan is fundamentally and economically indistinguishable from any of the other loans. Because the Debtor sold its interest in the GP Loan to Furst subject to the Agency Agreement, the GP Loan was just as encumbered by the bankruptcy as any other loan, it benefited from the Confirmation of the Plan just as much as any other investment, and it is subject to the terms of the Plan of Reorganization just like any other loan.

V. THE ARGUMENTS WITH REGARD TO THE 401(K)'S OBLIGATIONS SHOULD BE STRICKEN

Even though the Court has already stricken one pleading filed by Furst with regard to the 401(k) Plan's rights and obligations under the Plan of Reorganization, Furst's Reply again argues that the 401(k) Plan has no obligations related to the exit financing. As the Court knows, this precise issue was the subject of a briefing order issued by the Court in connection with the 401(k)'s OSC Application (Docket 2776). As such, Furst's arguments are premature and he lacks standing to bring them. These arguments should be ignored or stricken.

The undeniable fact is that Furst bought or acquired his investment through the Debtor. His interest should be the only one that is at issue here. As shown above, before Furst bought his interest or made his investment, the borrower owed that particular portion of the loan to the Debtor. In other words, before Furst acquired his interest, it was

essentially a "loan from the Debtor to [a] third party Borrower." (*See* definition of ML Note in Plan, at § 2.54) The borrower owed money to the Debtor, and the Debtor assigned its rights to receive that money to Furst, subject to the terms of the investment, which included the irrevocable Agency Agreement. This situation was clearly covered by the Plan of Reorganization. The Plan of Reorganization was never intended, nor is there any economic justification to draw distinctions between loans that the Debtor "originated" as opposed to loans that the Debtor "acquired." Indeed, in the very first paragraph of the POM it makes it clear that loans that were the subject of the investment in Mortgages Ltd. could be obtained by Mortgages Ltd. through origination or through loans that Mortgages Ltd. acquired. (POM, at p.1)("Each Loan will be originated ***or acquired*** by Mortgages Ltd…."). The fact that the Debtor acquired its interest in the GP Loan before it sold a share to Furst is irrelevant. Furst's position in the GP Loan is no different that any other investor in any other loan and the Plan covers his interest as well as that of any other investor in any other loan. The same can be said for every other investor in the GP Loan.

VI. CREATION OF A LOAN LLC, OR PLEDGING OF COLLATERAL FOR THE EXIT FINANCING IS IRRELEVANT

Finally, Furst makes a number of new, but irrelevant, arguments about the lack of a Loan LLC for the GP Loan, and the fact that his collateral was not pledged as collateral for the exit financing. The only issue properly before the Court on Furst's Motion is whether he can terminate his Agency Agreement with respect to this loan. There is nothing in the Plan, the Agency Agreements, or the exit financing documents that predicates the enforceability of the Agency Agreements with the existence of a Loan LLC, or the pledge of collateral as security. Moreover, the Court already made it clear when it ruled on the Rev-Op Group's Motion to Clarify that the Rev-Op Group would need to pay their fair share of the exit financing even though their interests were not pledged as collateral for the exit financing. In short, the fact that the pass-through investors' interests

1 were not identified as collateral or pledged as security under a security agreement does not
2 mean that they do not need to pay their fair share of the exit financing and other costs in a
3 "fair, equitable and non-discriminatory" manner. The amount of this share is scheduled to
4 be determined during hearing scheduled in September. All other arguments are irrelevant
5 to the only issue raised by this Motion.

6 **VII. CONCLUSION**

7 The new issues, arguments and evidence presented for the first time in Furst's
8 Reply should be stricken. Moreover, these issues, arguments and new evidence do not
9 provide a basis for the termination of the Agency Agreements with regard to GP
10 Properties.

11 DATED: July 27, 2010

12 FENNEMORE CRAIG, P.C.

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COPY of the foregoing mailed this
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