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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 BRIEF IN GP LOAN MATTER RE:** **(1) ML MANAGER'S INTEREST IN AGENCY POST-FORECLOSURE** **And** **(2) INVESTOR'S ABILITY TO TERMINATE AGENCY POST-FORECLOSURE** **Hearing Date: September 8, 2010** **Hearing Time: 1:30 p.m.**

At the August 2, 2010 hearing on the Motion filed by Robert G. Furst ("Furst") regarding the GP Loan (Docket 2716), the Court asked the parties to brief two issues: (1) Whether ML Manager's interest in the subject matter of the agency related to the GP Loan was eliminated by the completion of a trustee's sale, and (2) Whether all the investors in the GP Loan could effectively terminate their Agency Agreement for that loan post-foreclosure if they transferred their interests to one entity (*See* 8/2/10 Minute Entry, Docket 2861). As shown below, ML Manager's interest in the subject matter of its agency does not evaporate just because there is a foreclosure of the property. After a foreclosure sale, ML Manager continues to have a cognizable legal and equitable interest in the subject matter of the agency. Moreover, there are no set of facts before the Court that would allow the Court to find that the investors in the GP Loan had or have a right to terminate the agency agreement, and any finding based on an assumption of hypothetical facts that may occur in the future would be an improper advisory opinion. Moreover, on its face, the provision at issue does not justify the termination of the agency agreements.

I. ML MANAGER'S INTEREST IN THE SUBJECT MATTER OF THE AGENCY CONTINUES POST-FORECLOSURE

ML Manager had an interest in the agency before the foreclosure sale, the interest is significant (approximately 38% of the amount due and owing), and the interest does not evaporate just be cause there was a foreclosure sale.

A. ML Manager Has an Interest In the Subject Mtter of the Loan Management Agency.

This Court has already determined that ML Manager has a valid and recognizable interest in the subject matter of the agency.[1] For example, the Court has found that Mortgages Ltd. had a valid interest in, among other things, the "Interest Spread" and "Default Interest Spread" associated with the ML Loans.

> 67. The Debtor assigned an interest in many of its rights to investors, but the Debtor did not assign all of its rights. For example, the Debtor did not assign to the investors the right to seek the interest spread or default interest. This, among other things, gave the Debtor an interest in the ML Loans, which was the subject matter of the Loan Management Agency.

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[1] In the Hawkins' Adversary, the Court ruled that ML Manager had an interest in the subject matter of the agency under the *Hunt Doctrine.* In addition to its argument under the *Hunt Doctrine*, ML Manager also argued to the Court that its agency was irrevocable under the "power given as security" standard set forth by the *Restatement of Agency*. The Court questioned whether Arizona had adopted the *Restatement* standard, but found that the *Hunt Doctrine* test was satisfied. As the Court previously relied on the *Hunt Doctrine* test, ML Manager will confine its discussion here to that test. Nevertheless, ML Manager does not waive its argument that its agency is also irrevocable under the *Restatement* "power given as security" standard, which ML Manager also believes applies. To preserve its record, ML Manager incorporates by reference its arguments with regard to the "power given as security" standard as set forth in ML Manager's Brief in Response to the Rev-Op Group's Motion for Partial Summary Judgment filed the ML Manager v. Hawkins, et al Adversary, 2:10-ap-00430-RJH, at Docket Nos. 80-81.

(Declaratory Judgment (Hawkins et al. Adversary, 2:10-ap-00430-RJH, Docket 105) (the "Declaratory Judgment"), at ¶ 67)[2]. (In the Declaratory Judgment, the agency at issue was defined as the "Loan Management Agency." (*Id.* at ¶ 64) For consistency sake, that term will be used here as well.) The Court further found that through the confirmation of the Plan of Reorganization (the "Plan"), ML Manager obtained an interest in the loans and the Loan Management Agency. Specifically, the Declaratory Judgment found:

> 74. ML Manager continues to have an interest in the ML Loans and the subject matter of the Loan Management Agency. The Plan gives ML Manager the right to use, among other things, the interest spread and default interest for as long as needed.

(*Id.* at ¶ 74).

B. <u>ML Manager's interest in the GP Property Loan is significant.</u>

The best way to understand ML Manager's continued interest in the agency following a foreclosure sale is to look at the actual numbers and status of the loan immediately prior to the foreclosure sale. The loan at issue, ML Loan Number 860206 (the "GP Loan"), was originally made on July 18, 2007. (Attached as Exhibit A is a copy of the Loan Application.) The manager of the borrower, GP Properties, is Michael J. Peloquin ("Peloquin") and Peloquin and his wife guaranteed the loan. (*See id.*) The Fundamental Loan Terms, as set forth in paragraph 2 of the Loan Application, were as follows:

> (1) The initial term was to be 12 months.
>
> (2) The "Promissory Note Rate" was 12.25%.
>
> (3) The "Default Interest Rate" was 27%.
>
> (4) Monthly Interest only payments of $46,447.92 were to be made during the term of the loan.
>
> (5) Maturity date was July 19, 2008.
>
> (6) Principal balance due at maturity was $4,550,000.

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[2] A copy of the Declaratory Judgment was attached as Exhibit A to ML Manager's Supplemental Response in this matter (Docket 2856) (the "Supplement").

(*Id.,* at ¶ 2) In addition, the Promissory Note provides for a "Late Charge for Overdue Payments" in the amount of 3% of the remaining Principal balance (the "Late Charges"). (Promissory Note (a copy of which is as Exhibit B), at ¶ 7a).

1. <u>ML Manager has the rights to use the Interest Spread, Default Interest Spread and Late Charges</u>.

As demonstrated in ML Manager's Supplemental Response to Furst's Motion (Docket, 2856)(the "Supplement"), the GP Loan was partially funded by the Mortgages Ltd. 401(k) Plan (the "401(k) Plan"). Significantly, however, as can be seen from all of the loan documents, it was documented on Mortgages Ltd. forms, using Mortgages Ltd. personnel and intellectual property and part of the initial funding came from other sources. Simultaneously with the closing of the GP 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.[3] (*See* Supplement, at Exhibit C). The 401(k) Plan initially kept only 43.956% of the GP Loan.[4] **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 401(k) Plan assigned to the Debtor the entire 12.25% accrued interest rate** to be earned on its share of the Note. Significantly, however, the same was not true for the assignments to the MP Fund and Panagiotakopoulos. They only got 10% of the interest, leaving a 2.25% interest spread. (*Id.*) In other words, the assignments in the GP Loan clearly implicated the "Interest Spread" discussed in the Declaratory Judgment.

After receiving its 41.874% share of the GP Loan with the right to the full amount

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[3] 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. (Supplement)

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

of interest rate payable by the borrower, the Debtor began conveying its fractional interest in the loan to various investors (the "GP Investors"). (*See,* Supplement, at Exhibit D). In all, the Debtor assigned interests to over 20 other GP Investors and MP Funds.[5] **Significantly, however, in every case the Debtor assigned the GP Investors less than the full 12.25% interest rate payable by the borrower that the Debtor was entitled to receive. (*Id.*)** The Interest Spread the Debtor retained was between 3.25% and 0.25%. As such, there is no question that the net effect of all the assignments to the GP Investors was that the Debtor still retained the Interest Spread. (*Id.*)

Moreover, it is undisputed that all of the GP Investors and even the 401(k) Plan had Subscription Agreements and Agency Agreements with the Debtor, issued pursuant to the Private Offering Memorandum (the "POM"). A form copy of the Agency Agreement that governs the relationship with each of the GP Investors and the 401(k) Plan is attached as Exhibit C. As the Court will recall from all of the prior briefing on the agency issues, the Subscription Agreements, the Agency Agreements and the POM all provide that the Debtor is entitled to keep, among other things, Default Interest, which in this case is the difference between 27% and 12.25%, and the Late Charges. (*See, e.g.* Agency Agreement, Exhibit C, at § 1(c)(3); POM, at p. 8)[6] As such, the documents provide, and this Court has already ruled that ML Manager has an interest in the Interest Spread, the Default Interest and the Late Charges associated with GP Loan.

2. <u>The Interest Spread, Default Interest Spread and Late Charges are significant</u>.

It is undisputed that the GP Loan was in default, and was not repaid by its maturity date. On October 21, 2009, ML Manager as agent for the GP Loan Investors and the

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

[6] The Court can take judicial notice of the POM as it was filed in the Hawkins Adversary, as Exhibits 20 and 1 to the Verified Complaint, respectively, and referenced in the Declaratory Judgment, at ¶ ¶ 19, 24.

401(k) Plan, completed a trustee's sale under the GP Loan Deed of Trust. At that time, a Trustee's Deed was issued. (A copy of the Trustee's Deed is attached as Exhibit D.) Pursuant to the Trustee's Deed, title to the GP Loan Property was vested in the GP Investors and the 401(k) Plan. (*See* Exhibit D). The amount of the credit bid at the trustee's sale was $1,100,000.00.

In addition, on January 15, 2010, ML Manager, as the authorized agent for the 401(k) Plan and the GP Loan Investors, filed a lawsuit in Maricopa County Superior Court against GP Properties and the Peloquins (the "Deficiency Lawsuit") seeking, among other things, payment of the deficiency between the amount owed under the GP Loan and the amount of the bid at the trustee's sale. (A copy of the Complaint from the Deficiency Lawsuit is attached as Exhibit E.) The amount of the deficiency sought by ML Manager as a plaintiff on behalf of the 401(k) Plan and the GP Investors in the Deficiency Lawsuit was $7,343,429.77. Specifically, the GP Deficiency Lawsuit alleged as follows:

> 18. At the time of the trustee's sale, the total indebtedness due and owing under the Note was $8,447,239.57, as itemized below:
>
> Unpaid balance of Note
> Principal $4,550,000.00
> Interest @ Default Rate (27.00%) 1,709,662.50
> (From May 7, 2008 — October 21, 2009)
> Monthly Servicing Fees 480.00
> (From July 1, 2008 — October 21, 2009)
> Late Charge on Payment due July 1, 2008 16,256.77
> Late Charges on Matured Loan 2,157,215.80
> (From July 19, 2008 — November 21, 2009)
> Closeout Fees 1,500.00
> Recording Fees 100.00
> Attorneys' Fees 7,293.50
> Attorneys' Costs 383.24
> Posting of Notices 110.00
> Publication of Notice 427.96
>
> Total $8,443,429.77
>
> After subtracting the amount of the successful bid of $1,100,000.00 for the Property at the trustee's sale from the

> total indebtedness due and owing, there remains a deficiency balance due and owing to the Plaintiffs, of not less than $7,343,429.77, plus accrued and accruing interest, late charges, costs of collection and attorneys' fees. The deficiency balance continues to accrue interest at the default rate of 27.00%, until paid in full.

(Exhibit E, at ¶ 18)

3. ML Manager's Interest Just Prior to Trustee's Sale

In short, on the day prior to the Trustee's Sale, the total amount owing was $8,443,429.77. For purposes relevant to this discussion, this amount breaks down as follows: (1) Principal Balance - $4,550,000.00; (2) Interest at Interest Accural Rate of 12.25% - $775,680.21; (3) Default Interest Spread (difference between Default Interest Rate of 27% and Interest Accural Rate of 12.25%) - $933,982.29; (4) Late Charges - $2,173,472.57, and (5) Miscellaneous other charges - $10,294.70. In addition, the amount of the Interest Rate Spread, the difference between the Interest Accural Rate charged to the borrower, and the Interest Accural Rate assigned to the GP Loan Investors is $43,613.73. So, of the $8,443,429.77 currently owed, the breakdown between what belonged to the 401(k) Plan and the GP Investors (collectively, the "Investors") on the one hand, and what ML Manager had a right to use is as follows:

ML Manager		Investors	
Default Interest Spread	$933,982.29	Principal Balance	$4,550,000.00
Late Charges	$2,173,472.57	Assigned Interest	$732,066.48
Interest Spread	$43,613.73		
Miscellaneous	$10,294.70		
Total	$3,161,363.29	Total	$5,282,066.48

In other words, just before the trustee sale, the share that ML Manager had a right to use was over 38% of what was due and owing, or over $3.1 million.

C. <u>ML Manager's Interest Does Not Evaporate Following Foreclosure.</u>

As noted above, the Court has already found in the Declaratory Judgment that ML Manager has a right to use the Interest Spread, Default Interest Spread and Late Charges. (*See* Declaratory Judgement, at ¶ 74) Moreover, Section 4.13 of the Plan (Docket 1532), as modified by paragraph U(3) of the Confirmation Order (Docket No. 1755), provides as follows:

> Any Pass-Through Investor that does not transfer its fractional interest into a Loan LLC will receive its distribution pursuant to the existing Agency Agreement and other contracts which may be assigned to the ML Manager LLC. <u>Before such distribution are made, Pass-Through Investors who retain their fractional interests in the ML Loans shall be assessed</u> their proportionate share of costs and expenses of 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. (emphasis added).

In other words, based on the prior findings by the Court and the provisions of the Plan, ML Manager has a right (1) to use the Interest Spread, the Default Interest Spread, and the Late Charges for operations as long as they are needed, and (2) before making distributions to the GP Investors, to assess the GP Investors their proportionate share of costs, which, as the Court found in connection with the Rev-Op Group's Motion for Clarification (Docket 2323), includes the exit financing. Prior to the foreclosure sale, this meant that ML Manager had certain vested rights that allowed it to, among other things, seek in its own name to collect from the borrower 38% of the amount owed on the GP Loan, or over $3.1 million and charge back from any distribution their fair share of costs.

The question currently before the Court is whether ML Manager's right to seek to collect and use this money vanished because of the foreclosure sale. The answer is clearly no. *See, e.g., Mejia v. Industrial Comm'n of Arizona,* 202 Ariz. 31, 33, ¶ 7, 39 P.3d 1135, 1337 (App. 2002) (vested rights are not altered by future conduct).

The credit bid on the property was $1.1 million. The credit bid is treated as a payment on the debt owed by GP Properties. *See* A.R.S. § 33-812(A)(disposition of proceeds of sale; "trustee shall apply the proceeds from the trustee's sale in the following order of priority:" (1) cost of sale, (2) payment of "contract …secured by the trust deed," (3) payment of all other amount secured by trust deed, (4) association or other fees, (5) junior lienholders and finally the borrow.) So the initial question is that once the costs of the sale are paid, what is the allocation of the $1.1 million credit bid to the amounts due under the Note. The Promissory Note provides that payments:

> "will be applied to the following in such order as Holder, in its sole discretion, may determine,
>
> (i) To the payment of any costs, fees or other charges incurred under this Notes and the other Loan Documents;
>
> (ii) To the payment of accrued interest; and
>
> (iii) To the reduction of the Principal balance.

Promissory Note, at ¶ 4(b). This is consistent with common law principles providing that payment is applied to outstanding costs and interest first. *See, e.g. Story v. Livingston*, 38 U.S. (13 Pet.) 359, 371 (1839) ("The correct rule in general is that the creditor shall calculate interest whenever a payment is made. To this interest the payment is first to be applied; and if it exceed the interest due, the balance is to be applied to diminish the principal."); *Martin v. Martin*, 198 Ariz. 135, 138, 7 P.3d 144, 147 (App. 2000) (citing 47 C.J.S. Interest & Usury § 74 (1982); 45 Am. Jur. 2d Interest and Usury § 75 (1999)). Indeed, that is the correct analysis in determining the amount due in the Deficiency Lawsuit. The $1.1 million is applied to outstanding late charges and default interest, and interest continues to accrue on the entire principal amount.

If the contractual and common law allocation of payments to costs and interest first is applied here, the entire amount of the "payment" created by the credit bid would be subsumed by the Late Charges, Default Interest Spread, Interest Spread and Normal Interest. One argument is that because ML Manager has the right to use the "payments" applied to the Default Interest Spread, Late Charges and Interest Spread, ML Manager has the right to treat the proceeds of the foreclosure sale, the acquisition of the property, as a payment and allocate it to interest, which ML Manager has the right to use. Under the Plan, the GP Investors still hold the ownership right to the interest, but ML Manager has the right to use the proceeds. Once the property was disposed of, if ML Manager needed the money it could use the proceeds and account for it as an advance. Alternatively, ML Manager would, at that point, assess the GP Investors their share of the costs and expenses. In either event, ML Manager has a right to use the money. So whether ML Manager uses the money as an application of the interest, or assesses the GP Investors' their share of costs and then repays them from later loans with interest is functionally irrelevant. The point is that ML Manager's continues to have the right to use all of the proceeds from the disposition of the property and/or 38% of the amount owed. In other words, ML Manager's right to use 38% of the proceeds derived from the GP Loan does not change simply because the nature of the loan changed to from a contractual obligation to pay money to (1) a payment in the form of property valued at $1.1 million and (2) a cause of action for a deficiency. *See Van Loan v. Van Loan,* 116 Ariz. 272, 274, 569 P.2d 214, 216 (1977)(contractual right is not an expectancy but is a chose in action and is a form of property).

Van Loan is instructive. *Van Loan* is a divorce case where the wife was contested the right to the husband's unvested pension benefits. The husband argued that because his pension was not yet vested, the wife had no right in the proceeds after they do vest. The Court disagreed. Because the Court found that the "contractual right" to receive the pension benefits was a "property" right, the Court stated:

> As such, we hold that an employee, and thereby the community, does indeed acquire a property right in unvested pension benefits upon performance under the contract. Thus, to the extent that such a property right is earned through community effort, it is properly divisible by the court upon

dissolution of the marriage.

Van Loan, 116 Ariz. at 274, 569 P.2d at 216. In this case, the Court has already held that ML Manager has a contractual right to use money. That contractual right is the equivalent of a property right, and is not disturbed by the foreclosure sale.

Just as a lien or interest in property or personalty attaches to the proceeds of a sale of that property or personalty, ML Manager's equitable interest continued in the proceeds that were created by the trustee's sale. *See, Newbery Corp. v. Fireman's Fund Ins. Co.,* 106 B.R. 186, 187 (D. Ariz. 1989) (noting that equitable lien attaches to proceeds of a bonded contract); *c.f.* A.R.S. §47-9102(A)(64) (defining proceeds as, among other things "[w]hatever is acquired on the sale, lease, license, exchange or other disposition of collateral;" "[w]hatever is collected on, or distributed on account of, collateral" or "[r]ights arising out of collateral"); *see also Mejia,* 202 Ariz. at 33, ¶ 7, 39 P.3d at 1337 (holding that vested rights are not altered by future conduct).

Moreover, ML Manager's right to pursue the guarantors and borrower for a deficiency to be applied to the Default Interest Spread, the Interest Spread and the Late Charges, and then use that money for operations also was not affected by the foreclosure. Just as ML Manager had the right, before the foreclosure sale, to sue the borrower and guarantors in its own name to obtain money that it had a right to use, it has the same right after. In fact, that happened where ML Manager is a party to the Deficiency Lawsuit.

The bottom line is that ML Manager's interest in the subject matter of the agency, or its rights to collect and use 38% of the money owed by GP Properties and the Peloquins or $3.1 million and the right to allocate costs did not evaporate upon the completion of the Trustee's Sale. That means that ML Manager continues to have an interest in the Loan Management Agency, and its agency rights remain irrevocable.

II. THE INVESTORS CANNOT TERMINATE THE AGENCY AGREEMENTS BY TRANSFERRING THEIR INTEREST INTO ONE LLC.

As with all the other investors challenging the agency agreements, Furst's goal here is to avoid some or all of his share of the costs and shift those costs to other investors. While it is understandable that all investors would prefer to avoid as much of the costs as possible, it simply is not equitable. At the hearing, Furst posed a new hypothetical situation that all of the GP Investors might transfer their ownership interests into one common LLC, that then might be able to invoke the provisions of paragraph 3(b) of the Agency Agreements to terminate the agreements.[7] Paragraph 3(b) provides:

> If the ownership of any Trust Property becomes vested in Participant, either in whole or in part, by trustee's sale, judicial foreclosure or otherwise, Agent [ML Manager] may enter into one or more real estate broker's agreement on Participant's behalf for the sale of the applicable Trust Property … an may take such other actions and enter into such other agreements for the protection and sale of the applicable Trust Property, all as the Agent deems appropriate in its sole discretion. … Participant may terminate this Agreement after it becomes the sole owner of the Trust Property by written notice to Agent and payment of the fees, costs and expenses incurred by Agent as provided herein.

"Participant" is defined in the Agency Agreement as the individual investor or party to the Agency Agreement. Moreover, Participant is similarly defined in the POM.

The Agency Agreement is clear, if, following a trustee's sale, there is more than one Participant, the Agent, ML Manager may sell the property or take other specified actions. Indeed, the Court recently confirmed this right in paragraph 84 of the Declaratory Judgment ("(iv) initiate and complete a sale of real property in which the Rev-Op Group

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[7] Furst also argued that because all of the investors agreed, that the intent of Paragraph 3(b) was met even if there were more than one "Participant." This argument is inconsistent with the literal requirement of paragraph 3(b), which only allows termination if there is a single "Participant." As the issue unanimous consent has already been briefed and argued, ML Manager did not understand the Court's instruction on additional briefing to include this issue. As such, ML Manager has confined this brief to the new hypothetical issue of whether a future assignment might meet the requirements of paragraph 3(b).

[or other investor] has an interest provided that more than one investor has an interest in such property"). Under Paragraph 3(b), only if a single "Participant" owns 100% of the Trust Property may the Participant terminate the Agency Agreement. As an undisputed factual matter, that situation does not now exist. Instead, Furst has argued that the single owner for the property may be created in the future.

Legally, Furst's hypothetical situation is not a proper issue for this Court to rule on, and factually it is unlikely to ever exist. Furthermore, for the situation to ever arise, there would need to be proper assignments of the ownership interests. Such assignments are unlikely, and if they ever did occur, they could only occur in connection with the payment of an agreed upon amount of all outstanding obligations. If situation occurs, paragraph 3(b) will be moot as the parties will have necessarily agreed to a voluntary termination of the Agency Agreement.

A. <u>The Hypothetical Situation Proposed Seeks an Improper Advisory Opinion.</u>

The judicial power may only be exercised in a case properly before the court, meaning a case or controversy that is neither moot, a political question nor calling for an advisory opinion. *United States v. Richardson*, 418 U.S. 166, 171 (1974) (citing *Marbury v. Madison,* 5 U.S. 137 (1803).) Federal Courts have consistently refused to hear hypothetical cases that have not ripened into actual controversies. *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 101-102 (1998). This ripeness doctrine prevents courts from offering advisory opinions and is based in constitutional limitations on judicial power. *Id.* ("Hypothetical jurisdiction produces nothing more than a hypothetical judgment -- which comes to the same thing as an advisory opinion, disapproved by this Court from the beginning."); *Muskrat v. United States*, 219 U.S. 346, 362 (1911); *Hayburn's Case*, 2 U.S. 409 (1792); *see also Nat'l Park Hospitality Ass'n v. DOI*, 538 U.S. 803, 808 (2003) (quoting *Reno v. Catholic Social Services, Inc.,* 509 U.S. 43, 57, n. 18 (1993)). This consistent refusal to grant advisory rulings on unripe disputes is an "essential ingredient of separation and equilibration of powers" and should be vigorously upheld. *See Richardson*, 418 U.S. at 179; *Schlesinger v. Reservists Comm. to Stop the War*, 418 U.S. 208, 227 (1974).

Here, Furst's analogy is not a current controversy before this court. It is undisputed that all of the GP Investors have not transferred their interests into a single LLC. As demonstrated below, this hypothetical situation creates several logistical and administrative problems for the GP Investors and is not likely to occur. Accordingly, this Court, like all other courts, should refrain from making a speculative ruling on a matter that is not justiciable.

B. <u>Assignment of All Interests To One Single Entity Is Unlikely.</u>

There has been no evidence that all of the GP Investors are willing to assign all of their interests to one single entity. Curiously, such a structure is essentially the same structure under which ML Manager and the Loan LLCs operate. Significantly, several of the GP Investors have been extremely opposed to assigning an ownership interest in a loan to a separate entity for an ownership interest in that entity. They have argued such things as the concern that there would be an adverse tax consequence that would occur if such an assignment were made, or that such assignments are improper under the IRA or other vehicles through which they hold their investment. So there is a factual question of whether Furst could can ever get all of the GP Investors to make such an assignment.

In addition to the factual issue of whether all the GP Investors will agree to make such an assignment, there are both legal and factual issues as to whether they could ever effectively accomplish the assignments. As the Court will recall, the SEC initially filed an objection to the Official Investor's Committee's Plan of Reorganization challenging, among other things, the Pass-Through Investor's ability to exchange their ownership interests in the MP Loans for a membership interest for in the Loan LLCs. The SEC argued that the issuance of a membership interest in the new Loan LLCs constituted a "security" and this security was not registered. Ultimately, the SEC agreed that, given all of the information that was provided with the disclosure statement and the involvement of the Court in the confirmation process, the safe-harbor exemptions in Section 1145 of the Bankruptcy Code could be utilized to permit the transfers into the Loan LLCs. Nevertheless, the SEC was adamant that this not be an open window or indefinitely available. The SEC required that the window of time be limited and strictly controlled. That window expired on October 31, 2009. As the Court may also recall, the SEC also required the addition of specific restrictive language in the Plan stating that the membership interests in the Loan LLCs were not freely transferable. This is reflected in Aritcle VIII E.6 on p. 76-77 of the Approved Disclosure Statement.

The same situation applies here. Furst's hypothetical anticipates that over 20 investors will exchange an ownership interest in the Trust Property and cause of action for a "security," or a membership in an LLC. He does not indicate whether this "security" will be registered or is exempted from securities regulations. He does not state who would make the "offering" was setting up the new LLC, etc. There has been no analysis provided or securities opinion generated as to whether a transfer such as this will be permissible. As such, it is nothing more than speculation as to whether this hypothetical transfer would ever be legal.

In addition to the securities problems, it is unlikely that the 401(k) Plan could transfer its interest to this new entity. The entire reason that the 401(k) Plan was not included in any of the Loan LLCs was because the 401(k) Plan representatives argued that the 401(k) Plan could not transfer its ownership interest for a membership interest. Assuming that to be true, the 401(k) Plan could not transfer its interest into the anticipated new entity. For that reason alone, one "Participant" cannot own the entire Trust Property.

In addition to the possible securities and ERISA infirmities associated with the hypothetical proposed by Furst, there are contractual infirmities with the proposed transfer. First, the Agent, ML Manager, would need to approve and recognize the assignments. The Subscription Agreement executed by each of the GP Investors provides that each GP Investor:

> Represents and warrants that the Participations being acquired will be acquired for the undersigned's own account without a view to public distribution or resale and that <u>the undersigned has no contract, undertaking, agreement, or arrangement to sell or otherwise transfer or dispose of any Participations or any portion thereof to any other person.</u> (emphasis added).

(Subscription Agreement, at ¶ 2(h)). The Subscription Agreement continues:

> Agrees that the undersigned will not sell or otherwise transfer or dispose of any Participations or any portion thereof unless Participations are registered under the Securities Act and any applicable state securities laws or the undersigned obtains an opinion of counsel **that it is satisfactory to [ML Manager]** that such Participations may be sold in reliance on an exemption from such registration requirements.

(*Id.* at ¶ 2(m)). The Agency Agreement provides that the termination of the Agency Agreement is only effective after the payment of "the fees, costs and expenses incurred by Agent." (Agency Agreement, at ¶ 3(b)). The Agency Agreement further provides that it is irrevocable (Agency Agreement, at ¶ 1), and binding on the Parties and their agents … successors [and] assigns…." (*Id.* at ¶ 7(a)). With regard to any assignment, any amounts owing must be immediately paid. (*Id.* at ¶ 5(c)). The bottom line is that for Furst's hypothetical assignment situation to occur, ML Manager must agree to it, and there must be an agreement of, and immediate payment of all amounts owing. In other words, there cannot be an assignment to which ML Manager does not agree.

This requirement that there be an agreement to the assignment by ML Manager and an agreement between ML Manager and the assignor/assignee and payment of the amount owing makes the entire hypothetical untenable. Moreover, if all of those situations did occur, the issue would almost certainly be moot. As explained at the hearing on August 2, ML Manager is in the process of finalizing the allocation model so be used to make sure that all of the investors pay their fair and equitable share of the costs. That process is almost complete and will be shortly submitted to the Court and all parties. The next issue is for the Board to determine the circumstances under which investors may be released from the Agency Agreements and management of loans and assets. This has been described as the "Release Price" issue.[8] As there will essentially need to be an agreement on the Release Price in place to be able to effectuate an assignment in the first instance, there seems that there would never be a situation where such an agreement would be reached where it would be necessary to then complete an assignment so that one "Participant" would even be in the position to terminate the Agency Agreement. Instead, an agreement on and payment of the "Release Price" would terminate the Agency Agreement without all the other steps.

In short, there can be no assignment and involuntary termination of the Agency Agreement without the consent of ML Manager. Moreover, once ML Manager has reached an agreement on when termination is appropriate and the amount of the Release Price, assignment and voluntary termination issues become moot. The bottom line is that there are simply too many moving parts in Furst's hypothetical situation for the Court to rule on at this time.

III. <u>CONCLUSION</u>

ML Manager's interest in the Loan Management Agency does not evaporate upon the completion of a foreclosure. Furst's hypothetical assignment of interests to one "Participant" such that there could be an involuntary termination (from ML Manager's point of view) of Agency Agreements should not be considered by the Court.

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[8] The term "Release Price" may not be a technically proper characterization of the concept at issue as that term is typically applied to the release of property from a security interest, which does not apply here. Accordingly, it perhaps should be called a "Termination Price."

DATED: August 16, 2010

FENNEMORE CRAIG, P.C.

By *[/s/ Keith L. Hendricks]* (012750)
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COPY of the foregoing mailed this
16th day of August, 2010 to the following:

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/s/ L. Carol Smith