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IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re	Chapter 11
MORTGAGES LTD.,	Case No. 2:08-bk-07465-RJH
Debtor.	**ML MANAGER'S OMNIBUS REPLY IN SUPPORT OF ITS: (1) NOTICE OF LODGING ALLOCATION MODEL TO BE USED WITH REGARD TO THE DISBURSEMENT OF PROCEEDS TO THE NEWMAN LOAN INVESTORS, (2) NOTICE THAT ALLOCATION MODEL HAS GENERAL APPLICABILITY TO ALL INVESTORS, And (3) MOTION TO APPROVE ALLOCATION MODEL** **Hearing Date: Sept. 21, 2010** **Hearing Time: 1:30 p.m.**

Seven objections or reservations (Docket Nos. 2935, 2936, 2937, 2938, 2939, and 2940[1]) (collectively, the "Objections") have been filed in response to ML Manager's "Notice of Lodging Allocation Model. . ." (Docket 2913) (the "Allocation Brief"). The Court has already considered and resolved many or most of the arguments raised in the Objections. It is one thing to preserve the record and indicate that an argument is not waived, it is another thing to simply ignore all of the past rulings and pretend that the Court has not considered and ruled on various arguments. Many of the Objections step

[1] Sternberg emailed an Objection to ML Manager; however, it does not appear on the docket. As such, it is unclear if it was actually filed.

over this line. It is time to move forward and stop re-litigating the same issues over and over and over again. The Court should summarily reject all of the Objections that re-raise issues this Court has already resolved. These issues include, among others, the Court's prior findings with regard to whether Pass-Through Investors must pay their proportionate share of the Exit Loan and the application of the business judgment standard. The procedural Objections are also without merit. ML Manager did not set the schedule. ML Manager is merely complying with the Court's briefing schedule. Moreover, ML Manager is not asking the Court to resolve factual disputes at this point, and assumes that an evidentiary hearing will be set, if necessary, to resolve factual disputes.

In short, the Court should overrule any Objections based on previously adjudicated issues, reject the Objections based on flawed legal arguments, indicate that the Model is generally applicable to all Investors, and approve the Allocation Model subject to resolution of any factual disputes. To the extent that there are any material factual or evidentiary issues that need to be resolved in connection with the Allocation Model, the Court should set a schedule for limited discovery for those who have standing and who have raised legitimate factual issues, and set a evidentiary hearing, if necessary, to resolve those issues.

I. PROCEDURAL ISSUES

There are a few significant procedural points worth noting. First, as the Court is fully aware, ML Manager did not establish the procedure for the Allocation Brief. Moreover, prior to filing their Objections, only a couple of the Objectors sought the schedules and exhibits associated with the Allocation Model that were made available under this Court's Protective Order. As such, it appears that many of the Objections are either not based on the actual operation of the Model, or are based on misconceptions about the Model. Second, to the extent that any factual disputes exist with regard to the Model, ML Manager contemplates that the Court will need to resolve these disputes

through an evidentiary hearing. Third, this Court has jurisdiction to implement its prior rulings and approve the Allocation Model, but issues that have already been decided should not be re-litigated. Finally, the Objections represent only a small fraction of the 1800 Investors. This small but vocal group does not speak for the vast majority of Investors.

A. The Court Set the Schedule

Many of the Objections complain about the procedure and the timing of the Allocation Brief. The procedure that the Court adopted was in response to the Newman Loan Motion (Docket 2771) filed by Rosenfeld, a member of the Rev-Op Group, seeking to require ML Manager to make distributions from the Newman Loan. In response to that motion, ML Manager correctly pointed out that prior to making distributions ML Manager needed to assess costs and expenses to each Investor in a proportionate, fair, equitable and non-discriminatory manner. In other words, almost by definition, the distributions required the adoption of some sort of allocation method or model.

In resolving the Newman Motion, the Court set the procedure through the Newman Loan Order (Docket No. 2802). Significantly, none of the Objectors, or any other party, objected to the procedure set forth by the Court. Moreover, ML Manager, the Court and several of the Objectors have discussed procedure and the schedule in open court on several occasions without objection. Furthermore, no party objected to the Newman Loan Order, appealed it, or moved to reconsider or alter its deadlines. Indeed, there were no motions filed after the Allocation Brief seeking to extend any deadlines. As such, the complaint that there is a procedural defect with regard to the Allocation Brief or the timing is without merit.

Since the filing of the Allocation Brief, ML Manager has spent literally tens of hours in telephone conversations or meeting with Furst, Lewis/Underwood, the VTL, ML Liquidating Trust, the Oxford Investors and the Rev-Op Group. When requested, ML

Manager provided access to Peter Davis (the accountant that assisted with the preparation of the Model) and he spent many hours answering questions and generally explaining the Model.[2] These meetings appear to have been, and hopefully were, very productive in resolving or narrowing disputes.[3]

In any event, to the extent that there were objections to the procedure adopted by the Court, they should have been asserted in response to the Newman Motion, or at least following the entry the Newman Loan Order wherein the briefing schedule was established. The Objections that accuse ML Manager of improper conduct in following the procedure set forth in the Newman Loan Order should be rejected on their face.

B. Procedure for an Evidentiary Hearing

The real question should be the procedure going forward. As noted above, it is and always has been ML Manager's understanding that the hearing on September 21, 2010 is not an evidentiary hearing and is not intended to resolve factual disputes. To the extent that there are any factual disputes that need to be addressed, ML Manager anticipates or requests, if necessary, that the Court set a procedure to address such disputes in as efficient manner as possible. ML Manager anticipates that this procedure may require a three step process.

First, to avoid unnecessary costs and expenses and to conserve judicial resources, the interested parties should work together to identify and define the material issues that

[2] Furst called and asked questions before he filed his Objection, but did not ask for a copy of the schedules. Lewis and Underwood were the only Investors that requested a meeting or asked for the full information prior to filing their Objection. As such, all of the other Objections were filed without the benefit of a review full schedules and an explanation of the assumptions.

[3] On September 2, 2010, the Court entered a "Protective Order" approving ML Manager's proposed Confidentiality Agreement. Given the sensitive nature of certain Revenue Assumptions in the schedules, the Court approved the filing of the schedules and assumptions under seal. Pursuant to this Order, in a version filed under seal, ML Manager attaches as Exhibit A the schedules and assumptions associated with the Allocation Model, with a copy being provided to the Court. ML Manager anticipates using these schedules and assumptions at the hearing in accordance with the procedure set forth in the Court's Protective Order.

truly require discovery or an evidentiary hearing to resolve. ML Manager contemplates that there be a global "meet and confer" process wherein Investors would meet and discuss the matters for the purpose of identifying, resolving or at least narrowing any factual disputes. ML Manager will commit to be present at such a meeting and provide access to people knowledgeable about the Model and to answer any reasonable questions possible. As this meeting would be in an attempt to resolve or narrow issues, ML Manager believes that it should be subject to Rule 408, Federal Rules of Evidence.

Following this meeting, ML Manager anticipates that the parties would file a joint pre-trial statement identifying the issues to be tried and stipulating to any limited discovery legitimately needed, subject to the procedures in the September 2, 2010 Protective Order. If there is a disagreement as to the scope of the issues to be tried or discovery, ML Manager contemplates that this would be resolved by a short hearing or status conference.

Finally, ML Manager believes that there would be an evidentiary hearing, if necessary, to resolve any factual disputes. Until that time, ML Manager would continue to escrow the disputed amounts of any distributions. ML Manager has conferred with most of the Objectors and none have objected to this procedure.

C. The Court Has Jurisdiction, But Cannot and Should Not Overturn Prior Decisions that Are on Appeal

Some Objectors argue that the Court lacks jurisdiction because of the pending appeals. These Objections are misplaced. As the Court knows, there has been no stay pending appeal issued. The law is clear. A notice of appeal does not deprive the bankruptcy court of jurisdiction to implement its own orders. *See, In re Combined Metals Reduction Co.*, 557 F.2d 179, 190 (9th Cir. 1997). This rational is based on the principle that "the mere pendency of the appeal does not in itself disturb the finality of a judgment." *In re Mirzai*, 236 B.R. 8, 10 (B.A.P. 9th Cir. 1999) (*quoting Wedbush, Noble, Cooke, Inc.*

v. SEC, 714 F.2d 923, 924 (9th Cir. 1983). As a result, "[a]bsent a stay or supersedeas, the trial court . . . retains jurisdiction to implement or enforce the judgment or order. . . ." *In re Padilla*, 222 F.3d 1184, 1190 (9th Cir. 2000). A notice of appeal solely deprives the Court of jurisdiction to adjudicate anew the merits of an issue currently in the process of appellate review. *McClatchy Newspapers v. Central Valley Typographical Union No. 46*, 686 F.2d 731, 734 (9th Cir. 1982). A party seeking to prevent implementation of a judgment must establish each element necessary for a stay, and must provide the opposing party with adequate security. *See, e.g.*, *Nken v. Holder*, 129 S. Ct. 1749, 1761 (2009); *In re Combined Metals Reduction Co*., 557 F.2d at 190. Here, there is no stay of any of the prior Orders. As such, the only impact of the pending appeals is that they restrict the Court from reconsidering or altering its prior decisions on appeal.

D. <u>Only a Small Number of Investors Are Objecting</u>

Finally, regardless of the forum or method for considering disputed issues, another substantial fact that must be recognized in connection with the Objections is that they are essentially from the same small group of litigants that have been contesting some or all of ML Manager's actions over the last 15 months. There are over 1800 Investors that were involved with Mortgages Ltd, who had a total of over $900 million invested in 59 loans. Every one of those Investors were impacted by and involved with the Plan of Reorganization confirmed by the Court. During the Confirmation Hearing, the Court even commented on the extraordinary participation and involvement of the Investors during the confirmation process. *See,* Docket 2136 at p. 80-81. Nevertheless, almost all of the post-confirmation litigation has been initiated by or involved just a small number of all of these Investors. Of the 1800 Investors involved in Mortgages Ltd, only about 30-40 Investors, including the Rev-Op Group Investors, some of the so-called Oxford Investors, Sternberg, Furst and the Mortgages Ltd. 401(k) Plan, have been litigating with ML Manager. The vast majority of the other Investors have been actively supportive of ML Manager's action

as demonstrated by the large majorities and participation in the votes that have been taken by the Loan LLCs. Literally hundreds of Investors representing hundreds of millions in investments have all supported ML Manager's action in the various matters that have been put to a vote. So, in analyzing the Objections, it must be remembered that they come from an extremely small minority of Investors.

II. THE BUSINESS JUDGMENT STANDARD

Several of the Objections assert that the Court must test the Model pursuant to fiduciary duty standard of care, and not the business judgment rule. These Objections ignore (1) the fact that ML Manager was appointed by the Court as part of a confirmed plan of reorganization (the "Plan") to complete a specific job for the benefit of all Investors, (2) the evidence that was presented in connection with the confirmation of the Plan that the operative standard of care would be the business judgment standard, (3) all of the Court's prior orders issued after this precise issue was previously raised where the Court confirmed that the business judgment standard is what was required of ML Manager, (4) the Court's express findings that the proper exercise of business judgment meets ML Manager's fiduciary duties in these circumstances, and (5) the law regarding the nature of an agency is coupled with an interest, and that it is different from other agency principals. Instead of addressing any of these facts or points of law, the Objectors generally cite to inapposite agency law stating that an agent owes a fiduciary duty to a principal. This generic statement of the law is simply inapplicable to the facts of this case.

As a practical matter, the flaw with the application of the standard "fiduciary duty" argument to the facts in this case is that there are literally hundreds of separate, inconsistent and often conflicting interests at stake here. It is simply impossible to assert that ML Manager must or can comply with or satisfy the individual needs, interests, and directions of each individual Investor without consideration of any other Investor's needs, interests or directions. Some Investors may believe that property should be liquidated

immediately given concerns that the commercial market may further deteriorate,[4] or they may want to get what cash they can as soon as they can because they haven't received much money for over two years. Others may see the interest rate and default interest rate in the Exit Financing as the most significant concern. Some may believe that holding the property for long term potential is the best option despite concerns about the economy and accruing interest. Others may be willing to risk accruing interest in hopes of a favorable appellate court determination on things like agency issues, while others oppose such action. The bottom line is that this diversity of interests makes it impossible to address, effectuate or follow the desires or attempted instructions of every single Investor in every single decision. That is why, as has been discussed on several occasions with the Court, the traditional fiduciary duty standard applied at the individual Investor level is unworkable. Therefore, discussion of a traditional fiduciary duty standard is not helpful.

Moreover, as noted above, the cases cited by the Objectors are inapposite because none address the type of agency possessed by ML Manager. This Court has repeatedly determined that ML Manager holds an agency coupled with an interest. *See,* Transcript of May 26, 2010 Hearing at p. 1-5. Transcript of May 27, 2010 Hearing at p. 65. This type of relationship does not create a typical agency relationship as it places the agent and the principal in a potentially adverse relationship. *See, e.g., Restatement (Third) of Agency* § 1.04 cmt. f (2006). Indeed during recent hearings, this Court has described the agency coupled with an interest as more akin to a substantive property right than to a standard agency relationship. Consequently, an agent holding an irrevocable agency does not have

[4] At a recent hearing, counsel for the Rev-Op Group indicated that there was wide spread if not universal belief that the market was going to improve in the near term. The assertion that everyone believes that improvement is certain and imminent is simply not true, especially with regard to the commercial real estate market. For example, the Court can take judicial notice of all the recent articles in the Wall Street Journal™ among other sources regarding substantial concern about the future of the commercial real estate market given the increasing deficits, steady or rising unemployment, devaluation of the dollar against other major currencies, and many other alarming factors. There has even been lots of talk recently about a so-called "double-dip" recession.

typical fiduciary duties. *See id.* The law must and does allow an agent acting under an agency coupled with an interest to take into account the inherent conflict of interests that exist in the relationship. Thus, the Court's prior orders correctly require ML Manager to exercise its reasonable business judgment to fulfill its duties. *See,* May 26, 2010 Transcript p. 1-5 (holding that ML Manager has an irrevocable agency); May 27, 2010 Transcript at p. 65-67 (holding that ML Manager has met its fiduciary duty by exercising reasonable business judgment). This is entirely consistent with the Agency Agreement, which provided that all decisions would be made in the agent's "discretion."

Furthermore the application of the business judgment rule permits ML Manager to juggle the conflicting interest of literally hundreds of individual Investors. In the confirmation of the Plan, it was never contemplated ML Manager's role would be to consider, address and effectuate the individual desires and directions from each and every Investor. Instead, ML Manager was tasked with a specific job -- maximize the return for Investors while minimizing the costs. The Plan was based on the central management of the Loans for the benefit of the Investors as a whole and that ML Manager, being comprised solely of Investors whose only motivation is to maximize the return while minimizing costs, would use its business judgment in proceeding. *See, e.g.,* Disclosure Statement at p. 8; Plan at pp. 36, 38. In other words, the confirmation of the Plan essentially resolved this question. Thus, although the objecting Investors are not members of the Loan LLCs, it makes sense to consider the analogous duties owed to LLC members. To analyze the duties in a limited liability company, Arizona looks to authorities on corporations. *See Nutek Info. Sys., Inc. v. Arizona Corp. Comm'n*, 194 Ariz. 104, 106, ¶ 3, 977 P.2d 826, 828 (App.1998) (noting characteristics of a limited liability company that are equivalent to those in other types of organization). The "business judgment rule" is applied to decisions and actions of corporate management, providing some latitude for management's actions in their capacity as corporate fiduciaries. *See Tovrea Land and*

Cattle Company v. Linsenmeyer, 100 Ariz. 107, 129-30, 412 P.2d 47, 62 (1966). "It is the general rule that officers and directors of a corporation are authorized to handle the ordinary business affairs of the corporation according to their best judgments. . . ." *Id.* (quoting *Fagerberg v. Phoenix Flour Mills Co.*, 50 Ariz. 227, 71 P.2d 1022 (1937).

If there were any question as to the appropriate standard of care the Court's prior Orders resolve this issue. As noted in the Allocation Brief, the Court has repeatedly held that the business judgment standard is the correct standard and that the proper exercise of its business judgment satisfied any fiduciary duties owed. This is the law of the case and should not be disturbed. *Ingle v. Circuit City*, 408 F.3d 902, 904 (9th Cir. 1986) ("Under the law of the case doctrine, a court is generally precluded from reconsidering an issue previously decided by the same court, or a higher court in the identical case.")(quoting *Lower Elwha Band of S'Klallams v. Lummi Indian Tribe*, 235 F.3d 443, 452 (9th Cir. 2000)). Indeed, as some of those prior unstayed rulings are on appeal, the Court cannot and should not reconsider those rulings. Instead, the Court should implement them.

III. THE INDIVIDUAL OBJECTIONS

ML Manager will now go through and address each of the individual Objections.

A. The Lewis/Underwood Objections

The only issue that Lewis/Underwood raised in their Objection (Docket 2936) was whether individual Investors could pay their share of the Total Expected Costs early and stop accruing interest and some other General Costs (an "Early Payment"). In concept, ML Manager is not opposed to an Early Payment, but it is not really material to the Model at this point. Additionally, prior to accepting such a payment ML Manager would need to work out some of the details. Regardless, if there was going to be an Early Payment option, the Model must be in place to determine what the Early Payment would be. So the Early Payment is actually a second step in the process. There is no reason why this second step must be in place to approve the first step, and consideration of it now is akin

to putting the horse before the cart.

ML Manager is committed to addressing this issue, but there are some important details to consider and which have not been determined. For example, there is the issue of continued property management and control. Unlike the situation described in the Allocation Brief where all the Investors in an entire Loan would pay all the Total Expected Costs for that Loan and there would be no reason for ML Manager's further management of that Loan, when only one or a few Investors in a Loan paid their Total Expected Costs before final disposition of the Loan or its collateral, management of the Loan and the collateral would still need to be vested in ML Manager so that the remaining Investors' interests would be protected. Also, in situations where a Loan LLC exists and the Loan LLCs collateral has been pledged to the Exit Lender, the Exit Lender's lien would likely need to be released before an Early Payment option is available. Assuming these details can be worked-out, an Early Payment option is certainly a next step that ML Manager intends to address. However, as noted, that is not a reason to object to the Allocation Model, which is the necessary first step.

Finally, the Lewis/Underwood investors reserve the right to obtain more information about the assumptions and methodology behind the Allocation Model, and have requested an evidentiary hearing for this purpose. They have committed to continue to discuss any concerns and questions they have with ML Manager in hopes of avoiding any unnecessary litigation. This is an extremely responsible method for handling their concerns. This is consistent with the procedure that ML Manager proposes.

B. <u>VTL Objections</u>

The Value-to-Loan Opportunity Fund 1, LLC ("VTL") does not have standing to bring an Objection, and its Objections are without merit.

As indicated in its Objection (Docket 2937), the VTL is not an Investor. The VTL is a secured lender. Contrary to its Objection, however, it is not a secured lender to the

Loan LLCs. Instead, it is a secured lender to the MP Funds, which are members of the Loan LLCs.

The Allocation Model does not affect the right of the VTL in any way since the VTL is not a creditor of any Loan LLC but instead is a creditor only of all of the MP Funds as indicated in the Modification to Loan Documents attached to this response as Exhibit B (the "Modification"). While it is true that the rights of each of the MP Funds in the interests in loans transferred to the Loan LLCs were transferred to the Loan LLC subject to the security interest of VTL to protect VTL's security interest. This transfer does not make VTL a creditor of the Loan LLCs. The only rights that the VTL has are rights against the proceeds paid to a MP Fund when and if such distribution is made as provided in paragraph 6 of the Modification. Because the VTL is not a secured lender to the Loan LLCs, it has no standing to object to how costs and expenses are allocated to the Loan LLCs and Pass-Through Investors before distributions are made to the MP Funds. As such, the Objection should be overruled on standing grounds.

Substantively, the VTL's Objections are without merit. The VTL's first object that the Exit Loan costs are being allocated to the Loan LLCs. This Objection, like all those asserting that various classes of Investors should not be allocated costs, was resolved by the confirmation of the Plan and clarified in the Court's ruling on the Motion for Clarification. Moreover, there needs to be a reality check. If all of the Objectors positions were upheld, the Court would be ruling that nobody is going to pay any of the allocated costs. To argue that the Exit Financing and other costs cannot be allocated to the Investors simply ignores reality. Those costs must be paid. The payment of the costs is a key component of the Plan. To argue that the Loan LLCs cannot be allocated the Exit Financing and other costs should be rejected out of hand. Further, the VTL expressly consented to and subordinated to the Exit Financing in the Modification.

The VTL's final argument is the procedural argument about the briefing schedule.

This was addressed above.

C. Furst's Objections

Furst makes seven brief objections (Docket 2940) to the Allocation Model. None of which should be sustained.

Furst initially argues that the fiduciary duty standard should be applied. This has been addressed above.

Furst next argues that some loans will utilize ML Manager's services longer and should bear a greater portion of those operating costs. Factually, Furst's argument is misplaced because the Allocation Model assumes that when a loan's Total Expected Costs are paid, interest and costs are no longer accrued. The substantive question is whether the Court should second-guess the business judgment of ML Manager in considering and resolving this question. This is also addressed above. To the extent that there is a factual issue here, it will need an evidentiary hearing to resolve.

Furst's third argument is that the VTL should be assessed a portion of the costs. This issue was resolved in the adoption of Plan. Paragraph R of the Confirmation Order addresses the VTL treatment. Moreover, the substance of the VTL treatment was expressly set forth in the Plan and the Disclosure Statement. To the extent that Furst or any other party with standing had an objection to the VTL treatment, they should have and were required to assert them in connection with Plan confirmation. It is simply too late to re-write the VTL treatment now. *United Student Aid Funds, Inc. v. Espinosa*, 130 S. Ct. 1367, 1373 (2010) (holding that an unappealed plan is binding and not subject to review). As such, this Objection should be rejected.

The fourth argument is that there can be no allocation of costs where no Loan LLC was formed (the "Non-Loan LLC Loans"). This is simply wrong. Obviously, at the time of the confirmation, no Loan LLCs had been formed. The Plan and the Disclosure Statement made it clear that there may be some loans where no Loan LLCs would be

formed. However, nowhere was there any disclosure or statement made that only Investors in a loan where a Loan LLC Loan was formed would be subject to the costs, and this is not addressed in Paragraph U where costs are allocated to Pass-Through Investors.

The assertion that Non-Loan LLC Loans were intended to be exempted from repaying their share of costs is ludicrous. This is essentially arguing that the Investors were asked to vote for a Plan where they may or may not be required to pay substantial costs, but the decision on who would get a free ride had not yet been made, and when it was made they would have no input or choice. This is inconsistent with the Plan and the evidence at the confirmation hearing where it was repeatedly stated that all of the Investors would have to pay their fair share of the costs. It is inconsistent with the fact that all of the loans, including the Non-Loan LLC Loans, equally benefited from the resolution of the issues through the confirmation of the Plan. There was never any carve-out for a group of yet to be determined lucky Investors. Nor is there any logical basis for distinguishing the Investors in Non-Loan LLC Loans.[5] Finally, Furst conflates the security interest pledged by the Loan LLCs to the Exit Lender with the obligation to pay expenses. Of course, there can be an obligation to pay that is not secured by a collateral pledge. The fact that a Non-Loan LLC Loan did not incur the risk of having its loan, or a fraction of its loan pledged as security subject to the default remedies does not mean that they do not have to pay their share of the costs. Again, this issue has been decided long ago.

Furst next argues that the Model improperly allocates costs based on the relative outstanding loan balances of the ML Loans. Without citation, Furst baldly asserts that the

[5] Furst argues that Investors in Non-Loan LLC Loans are similar to a VTL member. The obvious difference is that the VTL was a secured creditor to the MP Funds, not an equity owner of the loans. There are always different risks associated with equity ownership as opposed to a secured lending relationship. Moreover, there was an express settlement with the VTL fund that was approved by the Court. No such settlement was sought, approved or implemented with the Non-Loan LLCs Loans.

Interborrower Agreement[6] provides that the allocation must be in accordance with the relative values of the Loan LLCs' interest which were pledged to the Exit Lender. That is simply an incorrect statement. In the first place, the Interborrower Agreement is an agreement between the Loan LLCs, the Liquidating Trust and ML Manager. As such, the fact that it provides for the allocation between the Loan LLCs is neither surprising nor significant. The significance of the Interborrower Agreement here is that Paragraph U of the Confirmation Order (as confirmed by the Court in the ruling on the Motion for Clarification) requires ML Manager to treat the Pass-Through Investors the same as it treats the Loan LLC Investors – no better, no worse. Therefore, the relevance of the Interborrower is that it sets the pattern to be applied to all Investors. Paragraph 3.1 of the Interborrower Agreement expressly provides that the allocation is:

> . . . in the ratio of the principal amount of their ML Notes on the date of the filing of the bankruptcy by the Debtor.

Moreover, paragraph 3.2 provides that the allocation will be:

> … among the Loan LLCs by the ML Manager on a basis which it considers fair and reasonable taking into account which loans require more or less servicing services.

(*See also* Paragraph 3.3) In other words, with regard to the Loan LLCs, the ratio for the allocation is the principal amount of the ML Notes on the date of bankruptcy, and ML Manager is to make the allocation based on it business judgment. ML Manager has done that and treated the Pass-Through Investors the same. This is what was contemplated and required.

Furst next argues that not all expenses incurred have been disclosed. Significantly, Furst has discussed the Allocation Model with both ML Manager's counsel and the chairman of its Board, but has asked to look at the schedules or detail. The expenses are available for examination.[7] Any legitimate additional issues that exist can be

[6] A copy of the Interborrower Agreement is attached as Exhibit C.
[7] Furst makes a comment about insurance for the ML Manager Board. There is insurance

dealt with by the procedures described above.

Finally, Furst asserts that the Pass-Through Investors should be able to terminate their agency agreements and act as tenants in common. This issue was thoroughly litigated in connection with the Declaratory Judgment action. The Court has held that ML Manager has an agency with an interest. The agency is irrevocable. ML Manager is willing to consider an "Early Payment" option to stop interest and costs from accruing on the conditions discussed above, but as long as ML Manager needs to protect the underlying property for some Investors, it will not and cannot be made to terminate the Agency Agreements. Once the Exit Financing has been paid and its liens released, the Total Estimated Costs for a loan have been paid, and provided that the Investors in the loan have an agreement on how they want to manage the loan going forward, termination of the Agency Agreement may be possible, but those details will need to be worked out.

D. Oxford Investors

The Oxford Investors (Docket 2939) first argue that Investors should be able to pay their share of the costs and stop further costs from accruing. This is essentially the Early Payment option argument and it has been dealt with above.

The Oxford Investors next assert that ML Manager's discretion in allocating costs between Loan Specific Costs and General Costs cannot be arbitrary. ML Manager does not believe that any such allocation has been arbitrary, but if there is a specific allegation of arbitrary action, it may need to be resolved in the evidentiary proceeding. One issue along these lines that can be considered is the fact that the Allocation Model provides that all costs allocated through the Model that were incurred prior to confirmation are considered General Costs and spread to all Investors on a proportionate basis (provided the loan is expected to recover an amount sufficient to pay its share). This was a point

in place for the Board, which is not only prudent but almost a necessity given the claims that are continually being asserted. This fact is neither surprising nor a reason not to approve the Allocation Model.

that was considered by ML Manager at great length, and there are many important factors that influenced ML Manager's decision.

For example, as the Court will recall, there was significant discussion during the Plan confirmation process regarding the allocation of costs between ML Manager and the Liquidating Trust. Ultimately, the money to pay costs on the ML Manager side of the ledger is derived solely from the ML Loans. On the other hand, the Liquidating Trust was given, among other things, REO and causes of action against third parties. It was anticipated that the Liquidating Trust would pay all of the general costs incurred by the Debtor and the portion of the Exit Financing associated with those costs. Ed McDonough even testified the DIP loans, and professional fees other than those like those incurred by Dax Watson who was representing Investors, would be borne by the Liquidating Trust. (Docket 2511, at p. 232-233) Prior to confirmation, that concept was also negotiated into and included in the Interborrower Agreement.

The Interborrower Agreement expressly provides that the "Stratera Claims" (the Mortgages Ltd's two DIP loans) and the "Allowed Administrative Claims" are in a category defined as "Claims Required to be Paid." (Interborrower Agreement at p. 3). Paragraph 2.2 then provides that the "Claims Required to Paid" "will be allocated to and become part of the Liquidating Trustee's Allocated Loan Share." As such, these expenses were expressly contemplated and agreed upon in the Interborrower Agreement to be considered general costs for Mortgages Ltd and allocated to the Liquidating Trust. ML Manager continues to hope and expect that the Liquidating Trust will recover money and pay these expenses. However, ML Manager is also contractually obligated to repay the Exit Loan even if the Liquidating cannot assist. Because it is likely that ML Manager will repay the Exit Loan before the Liquidating Trust has recovered money from the causes of action, this is reflected as an "Overpayment" by ML Manager under paragraph 2.5 of the Interborrower Agreement. At that point, the Liquidating Trust will have a "Repayment"

obligation with regard to the general costs for Mortgages Ltd's operations that it is required to pay. Accordingly, the allocation of the pre-confirmation bankruptcy costs as General Costs is not only consistent with the Plan, it is what was contemplated during the confirmation process. Many other factual reasons that when balanced justify the treatment of the pre-confirmation costs as General Costs.

The Oxford Investors arguments with regard to the Business Judgment standard are addressed above.

The Oxford Investors argue that "Uncovered Costs"[8] cannot be allocated to loans where there is a recovery. Query: What do the Oxford Investors and other Objectors who raise this same argument believe should happen to these costs? They can't be ignored or remained unpaid. Moreover, this issue was also conclusively resolved in the Plan and the Interborrower Agreement (which was in circulation and this point was agreed to prior to Confirmation). *See* Interborrower Agreement, at ¶ 3.5. As explained in the Allocation Brief, the premise of the Plan was that there would be no capital calls. This is absolutely clear with regard to the Loan LLCs and the MP Fund Investors, and ML Manager does not believe that it can or should treat Pass-Through Investors any differently from Loan LLC Investors. The testimony at the Confirmation hearing made it clear that all costs would be paid solely from distributions and that "Uncovered Costs" would be allocated to loans where there would be distributions. It is simply too late to re-litigate these types of issues.

The Oxford Investors argue that Pass-Through Investors cannot be assessed costs for the Exit Loan. As noted above, this issue has been resolved.[9]

[8] Uncovered Costs are costs that cannot be paid from distributions from a loan because there is no recovery or an inadequate recovery.

[9] As additional evidence that the Plan always contemplated that Pass-Through Investors who did not transfer their interests to the Loan LLC would be assessed their full share of the costs is seen in the Interborrower Agreement drafts that were circulated during the Confirmation hearing, and were made exhibits to the depositions that were conducted during that process. See Docket 2269, where the drafts of the Interborrower Agreement

The Oxford Investors argue that there is no methodology established for determining "Loan Specific" costs, or deadlines for distributions, and that assumptions should be updated over time. To the extent that there is a concern about these issues, they can be addressed in the form of Order approving the Model. ML Manager intends that all costs incurred since confirmation that are for a specific loan should be identified as a Loan Specific cost. Moreover, ML Manager intends to distribute proceeds as soon as reasonable practical. ML Manager also intends that the Allocation Model be dynamic in nature and that it will be regularly updated. When the updates justify further distributions or true-up because they reach a material point, ML Manager intends to make such adjustments and distributions.

The Oxford Investors argue that the "Sharing Ratio" should be based on the funded amount of the loans and not the principal balance as of the date of bankruptcy. This was addressed above.

Finally, the Oxford Investors make a confusing argument about the Replacement Loan Interest. It is unclear what the argument is, but the Replacement Loan Interest was another issue that was resolved by the Plan, the Disclosure Statement and the Interborrower Agreement. It was contemplated and agreed with the Exit Lender that the Exit Loan would be paid off from the first sales. This means that the Investors in those loans would be burdened with that responsibility. To compensate them for this burden, they were to receive Replacement Loan Interest. This concept cannot be changed now.

E. <u>The Rev-Op's Objections</u>

The Rev-Op Group initially argues (Docket 2935) that the Allocation Brief failed to comply with the Newman Loan Order. This is simply not true. The Allocation Brief

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that were being negotiated during the Confirmation were provided. These drafts, which were approved by, among others Lewis/Underwood's counsel and the Rev-Op Group's counsel, all expressly provide that the Pass-Through Investors would be assessed their full share of the costs. (See, e.g., Interborrower Agreement at p. 7)

provides a thorough description of the Allocation Model, and a notice that ML Manager believes it is generally applicable. That is what was required.

The Rev-Op Group argues that the Allocation Model is "virtually undecipherable." As noted above, this argument was asserted before the Rev-Op Group attempted to review the schedules and assumptions.[10] Given the several hours of meetings that it now has had with ML Manager's professionals, ML Manager believes that the Rev-Op Group now understands more about the Allocation Model and how it works. In any event, ML Manager stayed at the meeting until there were no further questions posed.

The Rev-Op Group argues that there is no basis to assess any costs to the Newman Loans or withhold distributions. The Rev-Op Group argues that the Newman Loan is not an ML Loan. The Newman Loan was clearly identified as one of the loans involved in the Mortgages Ltd. bankruptcy. *See* Exhibit B to Disclosure Statement. Moreover, there is no reason to distinguish it from any other loan at issue in the bankruptcy. The Investors in the Newman Loan were all subject to an agency agreement. The loan was managed by Mortgages Ltd., and then by ML Manager. There is no reason why it should be given any different treatment that any other loan.[11] The Newman Loan and the Investors in the loan were benefited from the settlement and resolution of the issues through the confirmation Plan just like any other Investor. Specifically, pages 59-64 of the Disclosure Statement identifies the benefit of the Plan, which included the resolution of such issues like the ownership of the Notes and Deeds of Trust, release of avoidance actions, and other issues. The Newman Loan Investors got these benefits just like any other Investor. Finally, if there is a factual issue with regard to whether the Newman Loan was or was not intended

[10] The Rev-Op Group complains about the Confidentiality Agreement procedure adopted by the Court, however, following the meeting with the Rev-Op Group, it indicated that it understood the reason for the procedure and no further objections were asserted at the meeting. It is unknown if the Rev-Op Group is now satisfied with the procedure or if it continues to assert some sort of an Objection based on this procedure.

[11] See the discussion about non-Loan LLC loans above.

to be part of the Plan, the Court would need to resolve this factual issue in an evidentiary hearing.

The Rev-Op Group next asserts that the "Offset Claim" cannot be asserted against the distribution to Rosenfeld. Significantly, the Rev-Op Group does not dispute or even refer to any of the indemnity or other provisions in the Agency Agreement. Contrary to the Rev-Op Group's unsubstantiated assertion, the amount of the pending fee application is not the sole basis for the Offset Claim. ML Manager believes that the indemnity provision of the Agency Agreement covers all fees incurred by ML Manager as a result of action taken by an Investor. There is no requirement that a Court award the money. In fact, the Agency Agreement requires the Investor to pay the amount owed under the indemnity obligation immediately, without Court order. Although ML Manager could have taken the position that it has the right to take and use amounts subject to the Offset Claim, it did not do so. ML Manager has simply recognized the existence of a dispute on this issue, escrowed the money in an interest bearing account, and is holding the money pending resolution. This is clearly the appropriate procedure here.

The Rev-Op Group's arguments about jurisdiction, the effect of the pending appeals and the business judgment rule is addressed above.

Finally, the Rev-Op Group's arguments about the procedure or the lack of review of the schedules and assumptions have been addressed above.

F. Sternberg's Objections

Sternberg's objections to the procedure are addressed above.[12] There was nothing nefarious or improper with the filing of the Allocation Brief. To the contrary, the Allocation Brief and the Model were the result of significant work and analysis that occurred right up until it was filed. There was no delay or intention to delay. Instead,

[12] As noted above, Sternberg emailed a copy of his Objection to ML Manager, but it does not appear on the docket. If it was not properly filed, it should not be considered.

there was solely a good faith effort to address some very complex issues in a thorough fashion based on the best information available. Moreover, the procedures suggested above should resolve all of Sternberg's concerns.

Sternberg next argues that prior decisions are not binding on all Investors. With regard to the issues decided in and resolved in the confirmation of the Plan, Sternberg is simply wrong. The confirmation of the Plan is binding on all Investors. Furthermore, Sternberg, himself, was a party to the Motion for Clarification and to the appeal from that Order. So he is also bound by that decision. He does not have standing to object on behalf of any other Investor, nor is he representing any other Investor.

Sternberg requests an evidentiary hearing. As noted above, ML Manager does not oppose this request. ML Manager simply requests that procedures be used so that the process is reasonable and not a burden on judicial resources.

Sternberg, as he did in the response to the Motion for Clarification, again argues that Pass-Through Investors should not be assessed their full share of the costs. This issue has been resolved and is on appeal. Given that he is appealing this issue, Sternberg is not now entitled to another bite at that apple.

Sternberg goes to great length to describe and attempt to distinguish the obligations of the Loan LLCs from the Pass-Through Investors. ML Manager recognizes that the Pass-Through Investors were not parties to the Interborrower Agreement. That is not the point. The point is that the Confirmation Order requires the Pass-Through Investors to be treated in a proportionate, fair, equitable and non-discriminatory manner. This means that they are treated no better, or no worse that the Loan LLC Investors. The relevance of the Interborrower Agreement is that it sets the pattern for how all Investors will be treated. As demonstrated in the Allocation Model, ML Manager is treating the Pass-Through Investors the same as the Loan LLC Investors in terms of allocation of the costs. The only difference is that the Loan LLCs members are required to pay substantially greater

amounts to the Exit Lender, and receive interest for that amount. However, neither the Loan LLC Investors nor the Pass-Through Investors receive interest for the Total Estimated Costs.

Sternberg argues that the Agency Agreement does not authorize the agent to borrow money on behalf of the Investor and assess the cost to the Investor. This is simply another species of the argument that the Pass-Through Investors are not responsible for the Exit Loan. Again, this was resolved in the Plan and again in the Motion for Clarification, and the issue is now on appeal. Moreover, the specific issue of ML Manager's ability to borrow money and assess the costs to the Investors was expressly ruled on in the Declaratory Judgment, at paragraph 85. There is no reason or justification, or even jurisdiction for the Court to alter or reconsider this ruling which is also on appeal.

Sternberg argues that he does not have sufficient information about the Allocation Model. Significantly, to date he has not made any effort to review the schedules or assumptions. This information is available to him just as it is to any other Investor.[13]

Sternberg's arguments regarding the fiduciary duty standard is addressed above.

Sternberg argues that he is in a separate and different situation because he negotiated a unique amendment to his agency agreement. ML Manager has recognized in the past and continues to recognize that Sternberg's situation is or may be unique. ML Manager further recognizes that it may require an evidentiary hearing to resolve this issue, however, that issue is neither pressing nor fully ripe. The only three loans that Sternberg

[13] Sternberg refers to the statements in the Allocation Brief about the General Costs being approximately 3%. This statement is true, but there is a clarification that is warranted. The Allocation Model identifies "General Costs" and "Loan Costs." The "Loan Costs" are about 1.7%. Combined, the General Costs and Loan Costs that are assessed to each loan that is able to pay its full share are slightly less than 4.8%. This combined amount of 4.8% plus the Loan Specific costs, and Interest Costs is the full amount of the Total Expected Costs. If there was any confusion or misunderstanding created to the reference to the General Cost amount without reference to the Loan Cost amount, it was unintentional and simply the result of time constraints.

is in are all in bankruptcy and the borrower bankruptcies are not close to resolution. As such, at this time there is nothing to distribute and no distributions against which costs can be allocated. If the Court concludes that Sternberg's Agency Agreement was terminated as of February 7, 2010, arguably it would terminate his obligation for the accruing of further interest and general costs. However, ML Manager believes that he would be liable for his share of Loan Specific costs under, at the very least, an unjust enrichment theory. Significantly, however, these issues may never need to be litigated. The numbers may simply not justify a dispute. Accordingly, ML Manager believes that the better course of action is to wait to see what happens with the borrower bankruptcies to determine if and when there will be distributions to fight about.

Sternberg's argument that only Loan Specific costs can be charged to the Pass-Through Investors is another backdoor argument that the Pass-Through Investors cannot be charged their share of the Exit Loan. No matter how he dresses-up the argument, he doesn't get another bite at the apple.

Sternberg's argument that Pass-Through Investors cannot be charged with amounts that were supposed to be paid by the Liquidating Trust is yet another dress on the tired argument that they are not responsible for their full share of the Exit Financing. The Court made it clear that Pass-Through Investors can be treated no better, or no worse that the Loan LLC Investors, and must bear a proportionate share.

Sternberg makes an argument that Pass-Through Investors should be given an "Early Payment" Option. This is dealt with above.

Finally, Sternberg provides a list of issues he alleges requires an evidentiary hearing. Most of these issues relate to his argument that the Pass-Through Investors cannot be assessed some, all or any portion of the Exit Loan costs under various theories. All of these issues should be rejected as the Court has already ruled on these issues and no evidentiary hearing is needed to address them.

G. The Mortgages Ltd Employee 401(k) Plan (the "401(k) Plan") Objections

Based on all of the previously asserted and pending motions regarding ERISA and other arguments, the 401(k) Plan argues (Docket 2938) that they should be excluded from the Model. The 401(k) Plan has filed a motion seeking to have a portion of the reference withdrawn so that these issues can be decided in U.S. District Court. It has also filed a motion asking this Court to abstain from reaching any merits of its claims until the issue of which forum should decide the issue has been determined. ML Manager agrees that the predicate issue that must be determined is which forum should consider the issues. ML Manager has, accordingly, filed a motion to continue all deadlines and response dates for these issues. At this point, ML Manager continues to believe that the issue of the Court's jurisdiction and the issue of the appropriate forum for the argument must be determined before the merits of any claims, including the 401(k) Plan's Objections can be considered.[14] For this reason, ML Manager has prepared an Allocation Model with and without the 401(k) Plan. If the Court reaches the point when confirmation of an Allocation Model is appropriate, the model without the 401(k) Plan can be implemented until the issues with the 401(k) Plan are resolved. If it is later determined that the 401(k) Plan should pay its share of the expenses, it will simply mean that additional distributions can be made to all the other Investors. For the Court's information, the 401(k) Plan's share of the costs, if it were treated like all the other Investors would be about $1.5 million. Of that amount, about $334,000 is Loan Specific costs. Whether the 401(k) Plan

[14] Even though it was the entity that filed the Motion to Withdraw the Reference and asked the Court to Abstain from ruling on the merits, it argues that the Court can and should rule in its favor on the merits of claims. This is improper. If the Court lacks jurisdiction, it cannot rule either way. It is fundamentally unfair and improper to argue that a Court lacks jurisdiction to rule against the 401(k) Plan, but has jurisdiction to rule in its favor. Such a procedure, if adopted, would allow a party a free bite at the apple without fear of consequences. Simply stated, if the Court lacks jurisdiction, as the 401(k) Plan asserts, it cannot rule on the issue at all. As such, the predicate issue must be which Court must hear the issues.

must pay its share of any amount will need to be determined.

Despite claiming that they are not subject to the Plan or the Costs, and despite the fact that they have asserted that the Court does not have jurisdiction to rule on the merits of its claim and should abstain, the 401(k) Plan makes several objections to the Model. First, it argues that the Model is a "radical departure from the Plan." Such hyperbole should be rejected on its face. The Model is the product of careful deliberation and analysis that faithfully effectuates the Plan as drafted and confirmed.

The 401(k) Plan argues against Replacement Loan Interest. This issue was addressed above and was contemplated in the Plan as evidenced by, among other things, Ed McDonough's testimony during the confirmation hearing. The 401(k) Plan next argues that the spreading of "Uncovered Costs" rewrites the Plan and constitutes impermissible "pooling." Again, this argument ignores the provisions of the Plan, Mr. McDonough's testimony, and the Interborrower Agreement that was negotiated before the confirmation of the Plan. Moreover, as asked above, what does the 401(k) Plan believe should be done with the "Uncovered Costs?"

The 401(k) Plan argues that loans without Loan LLCs cannot be assessed costs. This was addressed above.

The 401(k) Plan complains about the alleged inadequacy of the allocations and assumptions. Significantly, the 401(k) Plan never sought to review the schedules or assumptions. As such, their claims are simply not persuasive.

Finally, the 401(k) Plan argues that the business judgment rule should not apply to it. This goes to the heart of their ERISA claim and should not be considered or ruled upon until the predicate issue of the appropriate forum and jurisdiction arguments are resolved.

DATED: September 17, 2010

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