

1 Robert J. Miller, Esq. (#013334)
Bryce A. Suzuki, Esq. (#022721)
2 **BRYAN CAVE LLP**
Two North Central Avenue, Suite 2200
3 Phoenix, Arizona 85004-4406
4 Telephone: (602) 364-7000
Facsimile: (602) 364-7070
5 Internet: rjmiller@bryancave.com
bryce.suzuki@bryancave.com

6
7 Counsel for the Rev Op Group

8 **IN THE UNITED STATES BANKRUPTCY COURT**
9 **FOR THE DISTRICT OF ARIZONA**

10 In re:

11 MORTGAGES LTD.,

12 Debtor.

In Proceedings Under Chapter 11

Case No. 2:08-bk-07465-RJH

**OBJECTION TO ML MANAGER'S: (1)
NOTICE OF INTENT TO DISTRIBUTE
PROCEEDS IN ACCORDANCE WITH
ALLOCATION MODEL, AND (2)
MOTION TO APPROVE TREATMENT
OF DISTRIBUTION OF DISPUTED
PROCEEDS**

Hearing Date: January 11, 2010

Hearing Time: 1:30 p.m.

13
14
15
16
17
18
19 The Rev Op Investors,¹ and/or their successors and assigns, by and through undersigned
20 counsel, hereby file this Objection to *ML Manager's: (1) Notice of Intent to Distribute Proceeds*
21 *in Accordance With Allocation Model, and (2) Motion to Approve Treatment of Distribution of*
22 *Disputed Proceeds* [DE #3017] dated December 17, 2010 (the "Motion"). The Rev Op Group
23 submits that the Court must deny the Motion, which request for authorization (i) to surcharge all
24 investors for expenses allocable to specific loans, (ii) to pay expenses that ML Manager LLC
25 ("ML Manager") admits are required to be covered by the Liquidating Trust, and (iii) to offset
26
27

28 ¹ The Rev Op Investors are set forth on Exhibit A attached hereto.

1 unspecified and unproven “damages” against the Rev Op Group. In further support of this
2 Objection, the Rev Op Investors respectfully submit as follows:

3 **I. PRELIMINARY STATEMENT.**

4 As a threshold matter, the Rev Op Investors hereby give notice that ML Manager’s
5 ability to assess any portion of the Exit Financing and other non-servicing expenses to the Rev
6 Op Investors is currently at issue in a pending appeal before the United States District Court.
7 The Rev Op Investors submit that any disbursement of their loan proceeds to third parties is
8 improper while such appeal is pending, demand that adequate reserves be made by ML Manager
9 during the pendency of such appeal and any subsequent appeals to the extent any funds of the
10 Rev Op Investors are disbursed to third parties, and otherwise reserve all applicable rights.

11 Without waiving any such rights, the Rev Op Investors submit that ML Manager should
12 not be permitted to surcharge the Rev Op Investors for expenses in contravention of the heavily
13 negotiated Interborrower Agreement, the Plan, and ML Manager’s fiduciary obligations.
14 According to the Motion, ML Manager currently holds more than \$8.5 million from the
15 liquidation of certain loans and related real property, which funds ML Manager seeks authority
16 to distribute pursuant to ML Manager’s proposed allocation model.

17 In connection with its distribution of these funds, ML Manager seeks authority to charge
18 all investors, including the Rev Op Investors, for expenses related to the Tempe Land Company
19 loan (referred to as the Centerpoint Project), as well as professional fees incurred in the
20 bankruptcy case prior to plan confirmation. ML Manager’s request for authorization to
21 surcharge investors for these expenses as “General Costs” is nothing short of shocking,
22 particularly in light of ML Manager’s admission that the plan was negotiated on the premise
23 “that the *Liquidating Trust* would pay all of the general costs attributable to the Debtor.” *See*
24 *Motion*, pp.7-8 (emphasis added).

25 In addition, ML Manager seeks to setoff \$336,000 in asserted but wholly unsupported
26 “fees, costs and damages” against each of the members of the Rev Op Group on a pro-rata basis.
27 As a threshold matter, ML Manager has failed to provide any support for, let alone establish, its
28 asserted setoff. This Court has no record from which to approve the asserted setoff, which

1 record would be subject to significant dispute in any event. At a minimum, this Court would
2 need to conduct a lengthy evidentiary hearing to determine the propriety of the asserted setoff.
3 The Rev Op Investors reserve all rights in connection with these issues.

4 **II. ARGUMENT.**

5 **A. ML Manager Has a Fiduciary Duty to Investors.**

6 Contrary to ML Manager’s stated belief, this Court has not found or concluded that the
7 business judgment standard is the appropriate standard for examining the proposed allocation.
8 ML Manger is handling millions of dollars of the Rev Op Investors’ money as their self-declared
9 agent. An agent is a fiduciary of its principal. *See Musselman v. Southwinds Realty, Inc.*, 146
10 Ariz. 173, 175, 704 P.2d 814, 816 (Ct. App. 1984) (agents have a duty to act loyally “in all
11 matters connected with the agency relationship”). Indeed, ML Manager’s chief operating officer
12 has admitted on multiple occasions, including in sworn testimony before this Court, that ML
13 Manager is a fiduciary for investors, including the Rev Op Investors. ML Manager may not
14 “lower the bar” of its fiduciary responsibilities by invoking a business judgment standard for the
15 distribution of investor property.

16 Even if the business judgment standard were applicable (which it is not), however, ML
17 Manager clearly failed to comply with any such standard when it promulgated an allocation
18 model that violates the Interborrower Agreement, which was a heavily negotiated part of plan
19 confirmation. As discussed more fully below, the proposed allocation fails to comply with the
20 Plan as negotiated among the parties.

21 **B. By Written Agreement, Pre-Confirmation Professional Fees Must Be**
22 **Allocated to the Liquidating Trust or to Specific Loans or Investors.**

23 The Interborrower Agreement was a heavily negotiated component of the Plan, and the
24 Rev Op Investors were the principal creditor group driving those negotiations. As ML Manager
25 admits in the Motion, “the agreement reached prior to confirmation and documented through the
26 Interborrower Agreement was that the Liquidating Trust would be responsible for all the fees
27 except those incurred in representing individual investors in borrower litigation.” *See* Motion,
28 p.9:17-20. In contradiction of this admitted fact, the Allocation Model was designed so that “all

1 of the Exit Loan and other costs will be paid *from proceeds of the ML Loans.*” *Id.*, p.7:17-18
2 (emphasis added). In other words, the model proposed by ML Manager fails to allocate any
3 costs to the Liquidating Trust whatsoever.

4 Thus, the proposed allocation not only contravenes the Interborrower Agreement and
5 Plan, but eviscerates the heavily negotiated resolution that induced the Rev Op Investors to
6 withdraw their objections to plan confirmation. The Rev Op Investors are entitled to the benefit
7 of their bargain, and ML Manager should not be allowed to reverse course at this stage in this
8 case.

9 Moreover, the proposed allocation fails to comply with the mandate of the Plan that any
10 surcharge of their loan proceeds be made “in a fair, equitable and nondiscriminatory manner.”
11 *See* Confirmation Order ¶ U. Contrary to ML Manager’s assertion that a loan-specific allocation
12 would be “arbitrary, subjective, and impractical,” the Rev Op Investors initial review of the pre-
13 confirmation professional fees indicates that the majority of such fees could easily be allocated to
14 specific loans or investor groups. As just one example, it is difficult to understand why the
15 significant professional fees of the VTL investors should be allocated to all investors or why it
16 would be “impractical” to allocate such fees to the VTL investors only.² In sum, ML Manager
17 offers no more than conclusory arguments to support its proposed surcharge of millions of
18 dollars indiscriminately to all investors.

19 C. **Expenses Relating to the Centerpoint Project Must Be Assessed Against the**
20 **Centerpoint Project Investors or the Liquidating Trust.**

21 In the course of the Debtor’s bankruptcy case, the Debtor borrowed millions of dollars
22 from Stratera Portfolio Advisors LLC to make additional advances to Tempe Land Company in
23 connection with the Centerpoint project (the “Stratera DIP”). There was also significant
24

25 ² As with other aspects of the Motion, ML Manager has failed to provide any analysis, support,
26 or evidence (under seal or otherwise) to support its assertions that the pre-confirmation fees are
27 not allocable as specific costs. Due to confidentiality concerns raised by ML Manager, the Rev
28 Op Investors do not include any analysis herein but are prepared to rebut any evidence presented
by ML Manager at an evidentiary hearing.

1 litigation relating to the Centerpoint project. As set forth in the Motion, ML Manager seeks to
2 allocate these Centerpoint expenses to the loan proceeds (rather than to the Liquidating Trust)
3 and to spread these as “general costs” to all investors rather than to the investors in the
4 Centerpoint loan. ML Manager also asserts that the Stratera DIP was negotiated as a general
5 cost prior to confirmation. These assertions are misguided and misleading.

6 The Stratera DIP is not defined or mentioned in the Interborrower Agreement, and the
7 Rev Op Investors never agreed that it would be allocated as a “general cost” to be paid by
8 investors. Indeed, the Rev Op Investors emphatically deny that they reached any agreement that
9 the Stratera DIP “would be considered general costs and allocated to the Liquidating Trust if an
10 when it obtained money to contribute.” *See* Motion, p.8:5-8. From a strictly evidentiary
11 perspective, ML Manager will need to present significant evidence outside the four corners of
12 the Interborrower Agreement to prove this disputed contention.

13 Even such proof, however, would be largely unavailing. By ML Manager’s own
14 admission, even if the Stratera DIP could be considered a “general cost,” it should be covered by
15 the Liquidating Trust, not the investors. *See* Motion, p.8. Certainly, the Rev Op Investors never
16 dreamed, much less agreed, that they would be paying for the Stratera DIP from their pennies-
17 on-the-dollar recoveries.

18 Moreover, it is sophistry for ML Manager to assert that Centerpoint is a “cornerstone” of
19 the estate that benefits all investors and, accordingly, should be paid by all investors. More
20 accurately, Centerpoint is a millstone around ML Manager’s neck.

21 When making investment decisions with Mortgages Ltd., the Rev Op Investors generally
22 chose the properties in which they acquired loan interests. None of the Rev Op Investors has any
23 ownership interest in Centerpoint for good reason. They should not be penalized for their
24 discernment in avoiding Centerpoint, and ML Manager should not be allowed to “spread the
25 pain” to all investors for expenses that clearly should be allocated to a specific loan.

26 **D. The Asserted Setoff Claim Is Unfounded.**

27 ML Manager cannot prevail on an unproved, unsupported setoff claim, which itself is
28 based on disputed provisions of a form agency agreement. Even if such provisions were

1 applicable (which is the subject of a pending appeal and which the Rev Op Investors dispute),
2 ML Manager cannot prevail. The Rev Op Investors did not ask ML Manager to sue them in a
3 declaratory judgment action; they simply defended themselves (initially on an improperly
4 obtained order to show cause) and have exercised their appellate rights.

5 While ML Manager is quick to call it “a matter of fairness” to charge the Rev Op
6 Investors for the purported damages they allegedly caused, ML Manager fails to explain how the
7 professional fees of other specialized creditor groups—e.g., the VTL investors, Radical Bunny,
8 or the unsecured creditors committee—are properly spread to all investors. Essentially, ML
9 Manager is asking this Court to authorize it to recover all fees and other perceived “damages”
10 from specific investors only if such investors dare challenge ML Manager’s position or
11 otherwise exercise their legal rights against ML Manager’s wishes, even in a defensive posture.
12 This result cannot be countenanced.

13 Importantly, ML Manager has failed to establish its asserted setoff. No evidence or other
14 support is provided with the Motion. This Court cannot blindly approve a setoff of hundreds of
15 thousands of dollars in a vacuum of information. Thus, even if a setoff were proper under the
16 circumstances (which it is not), the Court would need to conduct an evidentiary hearing as a
17 matter of basic due process.

18 Moreover, the Rev Op Investors believe that they have significant counter-setoff claims,
19 which this Court has already determined remain viable pursuant to *In re De Laurentiis*
20 *Entertainment Group, Inc.*, 963 F.2d 1269 (9th Cir. 1992), *cert. denied*, 506 U.S. 918 (1992). At
21 a minimum, the Rev Op Investors should be allowed to confront any evidence of the asserted
22 setoff and to assert their counter-setoff in an evidentiary hearing before the Court.

23 WHEREFORE, the Rev Op Group requests that the Court enter an order:

- 24 A. Sustaining the objections set forth herein;
25 B. Denying the Motion; and
26 C. Setting an evidentiary hearing, as necessary.
27
28

1 DATED this 5th day of January, 2011.

2 BRYAN CAVE LLP

3
4 By /s/ BAS, #022721

5 Robert J. Miller
6 Bryce A. Suzuki
7 Two North Central Avenue, Suite 2200
8 Phoenix, AZ 85004-4406
9 Counsel for the Rev Op Group

10 COPY of the foregoing served via email
11 this 5th day of January, 2011:

12 Cathy L. Reece, Esq.
13 Keith L. Hendricks
14 Fennemore Craig, P.C.
15 3003 North Central Avenue, Suite 2600
16 Phoenix, Arizona 85012-2913
17 Counsel for the ML Manager, LLC
18 creece@fclaw.com
19 khendric@fclaw.com

20
21
22
23
24
25
26
27
28
29 /s/ Sally Erwin

BRYAN CAVE LLP
TWO NORTH CENTRAL AVENUE, SUITE 2200
PHOENIX, ARIZONA 85004-4406
(602) 364-7000

EXHIBIT A

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

- AJ Chandler 25 Acres, LLC
- Bear Tooth Mountain Holdings, LLP
- Cornerstone Realty & Development, Inc.
- Cornerstone Realty & Development, Inc. Defined Benefit Plan and Trust
- Evertson Oil Company, Inc.
- Brett M. McFadden
- Michael Johnson Investments II, L.L.C.
- Pueblo Sereno Mobile Home Park L.L.C.
- Queen Creek XVIII, L.L.C.
- Morley Rosenfield, M.D. P.C. Restated Profit Sharing Plan
- William L. Hawkins Family L.L.P.