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IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re MORTGAGES LTD., Debtor.	In Proceedings Under Chapter 11 Case No. 2:08-bk-07465-RJH **ML MANAGER'S RESPONSE TO REV OP GROUP'S MOTION FOR DISTRIBUTION OF REV OP INVESTOR FUNDS IN ESCROW** Hearing Date: March 10, 2011 Hearing Time: 1:30

The Rev-Op Group is attempting to force the costs of its failed attempts to thwart the Plan onto the backs of the other investors. Not only does this attempt flout fundamental fairness, it ignores the binding nature of the Agency Agreement. This Court has clearly held that the members of the Rev-Op Group are bound by the Agency Agreement. Accordingly, ML Manager is entitled to offset its attorneys' fees and costs from the funds held in escrow for three separate reasons. First, it is undisputed that the Rev-Op Group has taken repeated actions to interfere with ML Manager's implementation of the Plan. This interference constitutes a breach under the Agency Agreement and ML Manager is entitled to collect its damages pursuant to Paragraph 5(d) of the Agency Agreement (the "Interference Clause"). Second, the members of the Rev-Op Group are

required to indemnify ML Manager pursuant to Paragraph 4(a) of the Agency Agreement (the "Indemnity Clause"). Finally, the inherent equitable powers of the Court do not allow the Rev-Op Group to push the consequences of their actions onto the backs of the innocent investors. For these reasons, ML Manager respectfully requests that the Court deny the Rev-Op Group's Motion for Distribution of Rev Op Investor Funds in Escrow [Docket No. 3065] and allow ML Manager to impose its offset claim against the escrowed funds.

I. FACTUAL BACKGROUND

ML Manager is currently managing the investment interests of approximately 1800 individual investors who had invested approximately $900 million in Mortgages Ltd. at the time of the bankruptcy. The Rev-Op group consists of 13 individual investors, who did not appeal the Plan or the Confirmation Order, and who now are using every motion and procedure available to them as a means of preventing ML Manager from implementing the Plan.

This Court has already held that the members of the Rev-Op Group are bound by the Agency Agreement. Two provisions of the Agency Agreement clearly and unambiguously grant ML Manager the authority to offset costs and attorneys' fees from the escrowed funds.

First, paragraph 5(d) of the Agency Agreement provides for costs and attorneys' fees, among other damages, when Rev-Op interferes with the Agent's ability to perform:

> **Breach**. If Participant breaches this Agreement by failing to perform or by interfering with Agent's ability to perform under this Agreement, then participant shall pay Agent, within 30 days of written notice of breach, administrative fees, attorneys' fees, costs, closeout fees and any other fees or charges owed to Agent as compensation hereunder, along with any additional damages incurred by Agent, whether actual, incidental or consequential.

Agency Agreement at ¶ 5(d) (the "Interference Clause").

Second, paragraph 4(a) of the Agency Agreement provides for indemnification of ML Manager as an agent:

> Participant shall indemnify, protect, defend and hold Agent harmless for, from and against all liabilities incurred by agent in performing under the terms of this Agreement or otherwise arising, directly or indirectly, from any Loan or the Loan Documents, including all attorneys' fees, insurance premiums, expenses, costs, damages and expenses.

Agency Agreement at ¶ 4(a) (the "Indemnity Clause").

II. LEGAL ANALYSIS

To prevail on its motion, the Rev-Op Group must show that ML Manager is not entitled to offset the damages caused by the Rev-Op Group under any circumstances. In other words, if ML Manager demonstrates that it is entitled to costs and attorneys' fees under the Interference Clause, the Indemnity Clause or the equitable powers of the Court, then Rev-Op's motion fails. *C.f. Maleki v. Desert Palms Prof'l Props., L.L.C.*, 222 Ariz. 327, 334, ¶ 33, 214 P.3d 415, 422 (App. 2009) ("Because we conclude the superior court did not abuse its discretion in awarding fees pursuant to A.R.S. § 12-341.01(A), we need not consider its finding that fees also were appropriate as damages for Desert Palms' breach of the covenant of good faith and fair dealing."). Here, ML Manager is entitled to collect the costs and attorneys' fees from the Rev-Op Group pursuant to all three of its arguments. Therefore, the Rev-Op Group's motion fails.

A. The Interference Clause grants ML Manager the authority to offset costs and attorneys' fees from the escrowed funds.

The Rev-Op Group's motion nearly ignores the plain language of the Interference Clause. Indeed, the only argument that the Rev-Op Group makes with respect to the Interference clause is the argument that its members have not breached the Agency Agreement. This argument, however, lacks legal merit. ML Manager incurred all of the attorneys' fees at issue because the Rev Op Group continually interfered with ML

Manager's ability to perform under the Agency Agreement.[1] Accordingly, the Interference Clause obligates the Rev-Op Group to reimburse ML Manager the damages, including costs and attorneys' fees, caused by its interference.

The broad language of the Interference Clause expressly contemplates that the Agent will be made whole from all of the expenses and damages incurred as a result of the Participants interference with the Agent's duties. When a contract is clear and unambiguous the Court must give effect to the language as written. *See Goodman v. Newzona Investment Co.,* 101 Ariz. 470, 472, 421 P.2d 318, 320 (1966). The Interference Clause is clear and in no way ambiguous. Specifically, the Interference Clause states, in relevant part:

> If Participant breaches this Agreement . . . **by interfering with Agent's ability to perform under this Agreement**, then participant **shall** pay Agent . . . attorneys' fees, costs, ... along with any **additional damages** incurred by Agent, whether **actual, incidental or consequential**.

Agency Agreement ¶ 5(d) (emphasis added). This clause serves a dual purpose. First, the Interference Clause defines what the parties consider to be a "breach" of the Agency Agreement. The Agency Agreement defines "breach" to include any interference with the Agents ability to perform under the Agency Agreement. The Interference Clause also sets forth the consequences of a breach. This consequence is a mandatory payment of any damages caused by the interference, specifically including costs and attorney's fees. Thus, the Interference Clause means that if the Rev-Op Group has breached the Agency Agreement by interfering with ML Manager's ability to perform its role as agent, ML Manager is entitled to all damages incurred by the Agent as a result of the attorneys' fees and costs incurred as a result of the interference.

Here, it is undisputed that the Rev-Op Group interfered with the actions of ML

[1] Some examples of the Rev-Op Group's interference with ML Manager's exercise of agency authority are attached hereto as Exhibits A-G

Manager and consequently breached the Agency Agreement. The magnitude of the Rev-Op Group's interference has been well documented through the pages of the pleadings already filed in this bankruptcy. This Court can take judicial notice that the Rev-Op Group has fought ML Manager and nearly every turn. *See Arizona Title Ins. & Trust Co. v. Realty Inv. Co*., 6 Ariz. App. 180, 182, 430 P.2d 934, 936 (1967) (noting that the court may take judicial notice of indisputable facts). Additionally, on January 14, 2011, ML Manager sent a detailed letter to the Rev-Op Group outlining the repeated interference with ML Manager's agency (the "Breach Letter"). This Breach Letter is just the last in a series of notices, which began in October 2009, to the Rev-Op Group of its breach of the Agency Agreement. A true and correct copy is attached as Exhibit H. The Breach Letter summarizes the nature of Rev-Op's breaches:

> Among other things, [the Rev-Op Group has] actively taken steps to thwart ML Manger's implementation of the Plan. [Rev-Op Group has] challenged ML Manager's ability to act in the name of [the Rev-Op Group] in the Bankruptcy Court and in numerous other courts wherein actions relating to the Plan of Reorganization have been pending, recorded or filed unauthorized assignment documents or lis pendens. [The Rev-Op Group has] challenged and attempted to thwart settlement agreements, sale orders, marketing and sale of property, allocation of costs, and even distribution of proceeds. [The Rev-Op Group] recently filed actions challenging the enforceability of the 1st position deed of trust on the MK Custom property. These actions have crossed the line of general concern expressed by many investors to the point that [the Rev-Op Group is] the primary, if not sole obstacle or opponent to ML Manager's efforts to manage the ML Loans under the Agency Agreements.

Exhibit H at 3. The following list enumerates specific examples when Rev-Op has interfered:

1. The Rev-Op Group filed a Limited Objection to ML Manager's Motion for Substitution of Party Plaintiffs in 2:08-ap-00906-RTBP before the Honorable Redfield T. Baum, arguing that ML Manager is not the agent of the members of the Rev-Op Group.

2. The Rev-Op Group joined the debtor's response to ML Manager's motion to lift the automatic stay in 2:09-bk-31909-EWH. The debtor had argued that ML Manager did not represent the individual investors.

3. The Rev-Op Group objected to ML Manager's settlement agreement with the Grace Entities on the grounds that ML Manager did not act in the name of the Rev-Op Group. When these objections were overruled, the Rev-Op Group appealed the Bankruptcy Court's ruling to the District Court and opposed ML Manager's motion to dismiss the appeal. This appeal was eventually dismissed by the District Court on mootness grounds.

4. The Rev-Op Group objected to ML Manger's sale of the City Lofts Property on the grounds that ML Manager did not act in the name of the Rev-Op Group. When these objections were overruled, Rev-Op appealed the Bankruptcy Courts' ruling to the District Court and opposed ML Manager's motion to dismiss the appeal.

5. The Rev-Op Group objected to ML Manager's sale of the Zacher/Missouri Property on the grounds that ML Manager did not act in the name of the Rev-Op Group. When these objections were overruled, Rev-Op appealed the Bankruptcy Courts' ruling to the District Court and opposed ML Manager's motion to dismiss the appeal.

6. After the Bankruptcy Court ruled unconditionally, that the Rev-Op Group was bound by the Agency Agreements, the Rev-Op Group appealed this ruling to the District Court. This appeal has complicated many sales as title insurers are hesitant to issue title insurance in light of the pending appeal.

7. The Rev-Op Group objected to and opposed ML Manager's authority to vote on plans of reorganization in various debtor's bankruptcies.

8. The Rev-Op Group improperly filed litigation challenging the position of the 1st deed of trust with regard to the MK Custom property.

9. Some members of Rev-Op Group unilaterally purported to and recorded documents to transfer interests without complying with the requirements of the operative documents.

10. The Rev-Op Group has opposed and sought to avoid paying their fair share of the Exit Financing and other costs associated with the Plan of Reorganization.

11. The Rev-Op Group has repeatedly asserted objections and positions that have been rejected by the Court, but have required ML Manager to re-brief and re-argue the same issue over and over again increasing costs and expenses.

12. The Rev-Op Group caused titled companies to refuse to insure title to sale transactions that, at best delayed the closing of at least two projects, and have generally chilled and otherwise hindered ML Manager's ability to market and sale properties.

See Exhibit H at 3-4.

There is no question that Rev-Op Group has repeatedly and continually interfered with ML Manager's implementation of the Plan. Such interference constitutes a breach of the Agency Agreement. This breach permits ML Manager to recover any damages resulting from the interference from the Rev-Op Group pursuant to the Interference Clause. The Rev-Op Group does not dispute that their actions caused these damages. Accordingly, ML Manager is entitled to recover its offset claim from the Rev-Op Group.[2]

B. <u>The Indemnity Clause grants ML Manager the authority to offset costs and attorneys' fees from the escrowed funds.</u>

In addition to the Interference Clause, ML Manager is also permitted to offset its damages against the Rev-Op Group through the Indemnity Clause of the Agency Agreement. The Indemnity Clause states that the members of the Rev-Op Group will hold ML Manager harmless from any losses including attorneys' fees, insurance premiums, expenses, costs damages and expenses.

1. The Indemnity Clause clearly and unambiguously permits ML Manager to recover attorneys' fees and costs.

As noted above, indemnity provisions, much like any other contractual provision, must be given effect as written if the provision is clear and unambiguous. *Estes Co. v. Aztec Constr.*, 139 Ariz. 166, 168, 677 P.2d 939, 941 (App. 1983); *see also Grubb & Ellis Mgmt. Servs., Inc. v. 407417, L.L.C.,* 213 Ariz. 83, 138 P.3d 1210 (App. 2006). Accordingly, as it relates to indemnity clauses, the Court must grant indemnity for those

[2] The Rev-Op Group cites Agency Agreement ¶ 7(j) (the "Losing Party Pays Clause") as the operative provision governing this dispute. However, the Rev-Op Group is incorrect. The Losing Party Pays Provision awards attorneys' fees and costs to the prevailing party when enforcement or interpretation of the Agency Agreement is at issue. Thus, for example, when the Court determined that ML Manager was the prevailing party in the Declaratory Judgment Action, the Court could have awarded ML Manager its costs and attorneys' fees for that litigation under the Losing Party Pays Clause. In contrast, the attorneys' fees and costs that ML Manager is currently seeking to offset against the escrowed funds directly pertain to the Rev-Op Group's breach of the Interference Clause. Thus, the Rev-Op Group's reference to the Losing Party Pays Provision is inapposite.

damages "which reasonably appear to have been intended by the parties" to be protected by indemnification. *Herman Chanen Constr. Co. v. Guy Apple Masonry Contractors*, 9 Ariz. App. 445, 447, 453 P.2d 541, 543 (App. 1969). Further, when the language is clear and unambiguous, the court must enforce the indemnity provision as written. *MT Builders, L.L.C. v. Fisher Roofing, Inc.*, 219 Ariz. 297, 300, ¶ 10, 197 P.3d 758, 761 (App. 2008) ("And, when, as here, parties bind themselves 'by a lawful contract the terms of which are clear and unambiguous, a court must give effect to the contract as written.'"). Accordingly, based on the clear and unambiguous language of the Indemnity Clause, there are three arguments that provide for ML Manager to recover its attorneys' fees from the members of the Rev-Op Group under the Indemnity Clause.

First, the Indemnity Clause expressly permits ML Manager to collect its attorneys' fees from the indemnitor. Arizona law permits and enforces such clauses.

> The parties to a contract may, of course, expressly provide that one party will hold the other party harmless for any expenses, including attorneys' fees, incurred in connection with claims. Under such agreements, indemnification has been permitted for costs and attorneys' fees, even though the party claiming indemnification was not held liable to the plaintiffs.

Henderson Realty v. Mesa Paving Co., 27 Ariz. App. 299, 301, 554 P.2d 895, 897 (App. 1976); *MT Builders, L.L.C. v. Fisher Roofing, Inc.*, 219 Ariz. at 307, 197 P.3d at 768, ¶ 27 (App. 2008) ("Parties are free to contract . . . and they can agree the indemnitor will . . . be under a duty to reimburse the indemnitee's defense costs."). The Indemnity Clause states that "attorneys' fees" are recoverable by the indemnitee. This statement is enforceable under Arizona law. Thus, by the terms of the clear and unambiguous Agency Agreement, the indemnitee may recover its attorneys' fees from the indemnitor.

Second, the language of the Indemnity Clause that requires that the agent be held "harmless" for "all liabilities" is interpreted as permitting the indemnitee to collect its attorneys' fees. For example, the Delaware Supreme Court explained,

> The indemnity provision . . . is very broad in scope. It requires [the indemnitor] to indemnify and hold [the indemnitee] *harmless from and against all expenses*, including reasonable attorneys' fees. . . . Our case law recognizes that *where, as here, a party . . . is contractually entitled to be held harmless*, that party is entitled to its costs and attorneys' fees incurred to enforce the contractual indemnity provision. Any other outcome would not result in [the indemnitee] being held harmless.

Delle Donne & Assocs., L.L.P. v. Millar Elevator Serv. Co., 840 A.2d 1244, 1256 (Del. 2004) (emphasis added); *see also Henderson Realty v. Mesa Paving Co*., 27 Ariz. App. at 301, 554 P.2d at 897; *INA Ins. Co. v. Valley Forge Ins. Co*., 150 Ariz. 248, 255, 722 P.2d 975, 982 (App. 1986) ("A party is not 'held harmless' unless the indemnitor bears the indemnitee's costs of defending the third party's claim."); *Piedmont Equip. Co. v. Eberhard Mfg. Co.*, 99 Nev. 523, 528, 665 P.2d 256, 259 (Nev. 1983) ("An indemnitee is not 'held harmless' pursuant to an express or implied indemnity agreement if it must incur costs and attorney's fees to vindicate its rights."). Therefore, when, as the case here, the indemnitee "is contractually entitled to be held harmless" then the indemnitee is "entitled to its costs and attorneys' fees."

Third, broad indemnity clauses, such as the provision at issue, are generally interpreted as providing the indemnitee with attorneys' fees, despite the clause's silence on the recovery of attorney's fees.

> [T]he general rule of indemnification: [R]egardless of whether indemnity is based upon an implied or an express agreement, . . . when a claim is made against an indemnitee for which he is entitled to indemnification, *the indemnitor is liable for any reasonable expenses* incurred by the indemnitee in defending against such claim, regardless of whether the indemnitee is ultimately held not liable.

INA Ins. Co. v. Valley Forge Ins. Co., 150 Ariz. 248, 255, 722 P.2d 975, 982 (App. 1986) (emphasis added); *see also Commercial Standard Ins. Co. v. Cleveland*, 86 Ariz. 288, 295, 345 P.2d 210, 215 (Ariz. 1959) (awarding attorneys' fees to the indemnitee despite the fact that the indemnity clause failed to provide for them because the indemnity clause was

quite broad); *Oakview Treatment Ctrs., Inc. v. Garrett*, 53 F. Supp. 2d 1196, 1209 (D. KS. 1999) ("Even if the Court were to ignore [the express language allowing the indemnitee to recover attorneys' fees] . . . , the Court finds that [the indemnity provision] is sufficiently broad to allow recovery of attorneys' fees" by the indemnitee); RESTATEMENT (FIRST) OF JUDGMENTS § 107 ("Where a right of indemnity exists, the relation between the parties ordinarily entitles the indemnitee to recover not merely the amount of the judgment against him but also the amount of the expenses for attorney's fees.").

Here, because the Indemnity Clause expressly includes indemnity for all damages including attorneys' fees, the Court should permit ML Manager to offset the damages caused by the Rev-Op Group against the escrowed funds as these damages appear to be reasonably intended by the parties. *See, id.*

The Rev-Op Group claims that the parties never intended for the participant to indemnify the agent for litigation expenses. However, this statement is incorrect and reflects a very narrow reading of the broad language of the Indemnity Clause. The Agency Agreement clearly indicated that the principal would be responsible for any damages caused by its interference with the actions of the agent, including attorney's fees. Additionally, the Rev-Op Group's citation to section 7.j of the Agency Agreement is irrelevant. The Court has already awarded ML Manager fees for establishing its agency under Arizona law. The remaining offset claim involves the damages incurred by ML Manager as a result of the Rev-Op Group's continuous and unsuccessful attack on the Plan and Confirmation Order. These are not fees incurred establishing the agency relationship. These are damages suffered by ML Manager as a result of the Rev-Op Group's breach of the Agency Agreement. Finally, the Rev-Op Group has not produced any evidence that ML Manager is not obligated to pay the fees and damages incurred as a result of the Rev-Op Group's interference. Should the Court determine that this fact is relevant, ML Manager is happy to provide testimony limited to its obligations to pay the

damages incurred as a result of the Rev-Op Group's breach.

2. The Indemnity Clause of the Agency Agreement is not unconscionable.

First, the entire Agency Agreement is enforceable pursuant to the order of the Bankruptcy Court. Second, the Court should note the language used in the Rev-Op Group's motion: the Rev-Op Group is not contending that the Indemnity Clause is "unconscionable," rather the Rev-Op Group contends that ML Manager's interpretation of the Indemnity Clause is substantively "unconscionable." The test for unconscionability is not whether the "interpretation" by one party is unconscionable but rather whether the term on its face is unfair. *See Maxwell v. Fidelity Fin. Servs*., 184 Ariz. 82, 89, 907 P.2d 51, 58 (Ariz. 1995) ("Substantive unconscionability concerns the actual terms of the contract and examines the relative fairness of the obligations assumed.").

Finally, the Indemnity Clause is not substantively unconscionable. To quote the Rev-Op Group's motion, "[s]ubstantive unconscionable exists when terms are 'so one-sided as to oppress or unfairly surprise an innocent party." Rev-Op Motion for Distribution at 9 [Docket No. 3065]. The Rev-Op Group is a group of sophisticated investors who invested in the "Revolving Opportunity Loan Program" with Mortgages Ltd. The members of the Rev-Op Group cannot credibly claim that they were "unfairly surprise[d]" by an indemnity clause in the Agency Agreement. Indeed, a copy of the Agency Agreement was provided to each of the members of the Rev-Op Group with the Private Offering Memorandum. Although the Rev-Op Group further argues that the Agency Agreement is a contract of adhesion, the Bankruptcy Court has addressed this issued in previous litigation and determined that the Agency Agreement binds the members of the Rev-Op Group. *See,* Declaratory Judgment entered in 10-ap-00430 [Docket No. 105].

3. ML Manager's enforcement of the Indemnity Clause is not a breach of its fiduciary duties owed to the 1,800 investors.

Importantly, ML Manager is managing the interests of over 1,800 individual investors, each of whom maintain a different opinion as to the eventual disposition of the Loan Portfolio. The Rev-Op Group consists of 13 investors. The Bankruptcy Court has repeatedly held that ML Manager has fulfilled its fiduciary duties to all of the investors by utilizing its reasonable business judgment in dealing with the Loan Portfolio.

Regarding Rev-Op's claims with respect to Mr. Hawkins, ML Manager attempted to work with Mr. Hawkins when he served as a member of the Board. Eventually, Mr. Hawkins *voluntarily* resigned from the Board during the time that there was legal action pending with regard to his seat on the Board. Thus, there are no facts upon which to assert that ML Manager has breached its fiduciary duties.

C. Equity demands the award of attorneys' fees and costs to ML Manager.

Irrespective of the contractual obligations, the Court should also consider the equities involved in these issues. The costs at issue are actual damages incurred as a result of Rev-Op's interference with the ML Manager's administration of the Plan. These damages must be paid and will not disappear solely because the Rev-Op Group so desires. If the Rev-Op Group is not required to pay the costs of their unsuccessful interference, then the innocent investors, those investors who did not seek to disrupt the Plan, will be forced to bear this burden. It is inequitable to permit the Rev-Op Group to push the costs of its interference onto the backs of all other investors involved who have complied with the Plan. The Plan is clear that all investors must pay their share of the costs. This does not mean that they have to fund the Rev-Op Group's assaults on the Plan.

III. CONCLUSION

Rev-Op's motion fails because it lacks merit. Specifically, ML Manager is entitled to attorneys' fees and costs pursuant to the Indemnity Clause and the Interference Clause.

The Court need only find that one of the provisions at issue warrants the award of costs and fees to ML Manager for Rev-Op's motion to fail. Because Rev-Op does not challenge the enforceability of the Interference Clause and because Rev-Op clearly breached the Agency Agreement, the Interference Clause alone leads to the conclusion that ML Manager may collect attorneys' fees and costs from the escrowed funds. Thus, the Court should deny Rev-Op's motion to compel distribution of the escrowed funds.

DATED this 18th day of February, 2011.

FENNEMORE CRAIG, P.C.

By /s/ Keith L. Hendricks
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CERTIFICATE OF SERVICE:

I hereby certify that on February 18, 2011, I electronically transmitted the attached document to the Clerk's Office using the CM/ECF system for filing and transmittal of a Notice of Electronic Filing to the CM/ECF registrants.

COPY served via email this 18th day of February, 2011:

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