UNITED STATES DISTRICT COURT

DISTRICT OF ARIZONA

CORDELLO et al., Plaintiffs, vs. ML MANAGER LLC, Defendant.	2:10-cv-01862-RCJ **ORDER**

This case arises out of the Confirmation Order issued in *In re Mortgages, Ltd.*, No. 2:08-bk-07465-RJH) (the "Bankruptcy Case"). Rather than appeal the relevant provisions of the Confirmation Order directly under 28 U.S.C. § 158, Plaintiffs filed the present action pursuant to 28 U.S.C. §§ 1331, 2201(a) and 29 U.S.C. § 1132(e)(1) for declaratory judgment against Defendant ML Manager LLC, an entity created by the bankruptcy court to manage the real property and related assets of Debtor Mortgages, Ltd. Plaintiffs have moved for judgment on the pleadings against one of Defendant's counterclaims for declaratory judgment. At oral argument, the Court identified a jurisdictional problem with the case and invited supplemental briefs. The Court has read the parties' briefs. For the reasons given herein, the Court refers the case to the Bankruptcy Court.

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I. FACTS AND PROCEDURAL HISTORY

A. Overview of Related Cases

Mortgages, Ltd. brokered, serviced, and sold factional interests in mortgages. In response to defaults or mismanagement of assets, it allegedly transformed itself into a Ponzi scheme, paying old investors with the funds it received from new investors. In 2008, Mortgages, Ltd. filed for bankruptcy under Chapter 11, a few weeks after its CEO committed suicide and a few days after one of its mortgagors filed an involuntary petition under Chapter 7. The Confirmation Order created single-purpose entities to hold Debtor's interests (fractional ownership and/or servicing rights) in various loans and created ML Manager to implement the Confirmation Plan.

The present case is one of many arising out of the affair. Some of the cases concern various investors' and mortgagors' tort claims against Debtor and its former employees and associates. Some of the cases concern minority interest holders' objections to ML Manager's disposal of Debtor's real property at the direction of majority interest holders. One of the cases is a criminal action by the SEC against one of Debtor's main investors, Radical Bunny LLC, and four of Radical Bunny's principals.

B. The Mortgages Ltd. 401(k) Plan

The present case concerns the propriety of ML Manager's actions under the Confirmation Order affecting the assets of the Mortgages Ltd. 401(k) Plan (the "Plan"). Plaintiffs James Cordello and Ryan Walter are the Plan's trustees, and ML Manager is the sole Defendant.[1] Mortgages, Ltd. established the Plan in 2001, and as of its termination on December 31, 2008, its assets consisted of an unspecified amount of cash, three loans, and fractional interests in five

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[1]ML Manager notes that the estate of Mortgages, Ltd.'s deceased former CEO is the Plan's primary beneficiary, and that other bad actors in the Mortgages, Ltd. affair account for many of the Plan's other beneficiaries.

loans: (1) Vanderbilt (64.08%); (2) Hurst (93.52%); (3) CDIG (100%); (4) Ecco (100%); (5) GP Properties (46.86%); (6) 43rd & Olney (87.5%); (7) Downtown Community Builders (100%); and (8) Bisontown (63.99%). (*See* Compl. ¶¶ 9, 12, 16, August 30, 2010, ECF No. 1). Seven of these loans have been foreclosed. (*See id.* ¶ 17). The Plan remains in existence purely for liquidation of its assets via the Bankruptcy Case. (*See id.* ¶ 16).

C. The Confirmation Order

The bankruptcy court issued the Confirmation Order on May 20, 2009. (Countercl. ¶ 3, Sept. 23, 2010, ECF No. 7). Plaintiffs did not appeal any aspect of the Confirmation Order. (*Id.* ¶¶ 38, 43). The Confirmation Order confirmed The Official Committee of Investors' First Amended Plan of Reorganization Dated March 12, 2009 (the "Confirmation Plan"). (*See* Confirmation Plan, Mar. 12, 2009, ECF No. 1468 in Case No. 2:08-bk-07465-RJH). The docket in the Bankruptcy Case indicates various objections to confirmation but no objection to confirmation by Messrs. Cordello or Walter, the Plan itself, or any other entity purporting to represent the Plan.

The Confirmation Plan defined "Investors" as "all persons holding fractional or participating interests in the ML Loans or in the MOP Funds which hold fractional or participating interests in the ML Loans . . . excluding the Debtor." (*Id.* § 2.40). The Plan is therefore probably an Investor under the Confirmation Plan by virtue of its interests in eight ML Loans. Any Investor with respect to a given ML Loan was to receive a respective fractional interest in the Loan LLC created to hold that ML Loan. (*See id.* § 4.7). ML Manager was to manage each Loan LLC pursuant to an operating agreement "in the form of Exhibit K to the Disclosure Statement [to the Confirmation Plan]." (*See id.* § 4.10). Section 4.11 of the Confirmation Plan is critical to the present case, because its interpretation and validity under ERISA may be dispositive to the various declarations the parties seek:

> Upon the concurrence of the Effective Date and after establishment of the

> Loan LLCs and upon the transfer of ML Loans to those Loan LLCs, all existing agencies, powers of attorney, servicing, and related contracts between Investors or the MP Funds and ML will be transferred and deemed assigned to the ML Manager LLC, and will be deemed modified to conform with the terms of the operating agreements of the ML Manager LLC and each Loan LLC.

(*Id.* § 4.11). This provision is critical because Plaintiffs seek declarations that certain previous contracts control the parties' abilities to affect the assets of the Plan, and that anything in the Confirmation Plan to the contrary is void as a prohibited transaction under ERISA. Defendant seeks a declaration that the Confirmation Plan is valid and that it in fact transferred to ML Manager the ability to manage the Fund's assets and use them to pay the Plan's fair share of administrative costs as an Investor, pursuant to the Confirmation Plan.

D. The Exit Financing

ML Manager required operating capital in order to function. The Confirmation Plan provided that capital would be obtained through a third-party loan (the "Exit Financing"), the details of which were incorporated via Exhibit O to the Disclosure Statement to the Confirmation Plan. (*See id.* § 4.15).[2] Plaintiffs object to ML Manager's use of any part of the Plan's fractional interests in the proceeds from the sale of properties themselves and ML Manager's use of any part of the Plan's fractional interests in late fees, default interest, and the like arising out of the properties held by the Loan LLCs as contrary to pre-Confirmation Plan contracts and ERISA. Finally, the Confirmation Plan provides that the bankruptcy court retains jurisdiction *inter alia* "[t]o determine all controversies and disputes arising under, or in connection with, the Plan and all agreements or releases referred to in the Plan, and any disputes regarding the administration of the Estate by the Liquidating Trustee." (*Id.* § 9.1(e)).

E. The Present Case

Plaintiffs sued ML Manager in this Court on four causes of action: (1) declaratory

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[2]The Exit Financing was a three-year, $20 million loan. (*See* Letter, Mar. 12, 2009, ECF No. 1466-11 in Case No. 2:08-bk-07465-RJH).

judgment that ML Manager is not an agent of the Plan, that any state law to the contrary is preempted by ERISA, and that ML Manager has no authority to use, control, or sell any Plan asset; (2) declaratory judgment that if ML Manager does have the right to dispose of Plan assets, then it is by law a fiduciary of the Plan and any disposition of the Plan's assets to any party other than the Plan's beneficiaries would constitute a breach of fiduciary duty and a prohibited transaction under ERISA; (3) declaratory judgment that late fees, default interest, and "interest spread" to the extent of the Plan's fractional interest in the loans are assets of the Plan, and that ML Manager's retention or other disposition of such proceeds would constitute a breach of fiduciary duty and prohibited transaction under ERISA; and (4) injunctive relief preventing ML Manager from disposing of the Plan's assets. Defendant ML Manager filed a Counterclaim, listing three causes of action: (1) declaratory judgment that Mortgage Ltd.'s agency authority with respect to the plan has been validly transferred to ML Manager, that the Plan is liable for its fair share of costs and expenses resulting from Mortgage Ltd.'s bankruptcy, and that ML Manager may allocate the expenses accordingly; and, in the alternative if ERISA preempts the agency assignment, (2) unjust enrichment and (3) quasi-contract. Plaintiffs have moved for judgment on the pleadings as to the first counterclaim.

II. LEGAL STANDARDS

Federal Rule of Civil Procedure 8(a)(2) requires only "a short and plain statement of the claim showing that the pleader is entitled to relief" in order to "give the defendant fair notice of what the . . . claim is and the grounds upon which it rests." *Conley v. Gibson*, 355 U.S. 41, 47 (1957). Federal Rule of Civil Procedure 12(b)(6) mandates that a court dismiss a cause of action that fails to state a claim upon which relief can be granted. A motion to dismiss under Rule 12(b)(6) tests the complaint's sufficiency. *See N. Star Int'l v. Ariz. Corp. Comm'n*, 720 F.2d 578, 581 (9th Cir. 1983). When considering a motion to dismiss under Rule 12(b)(6) for failure to state a claim, dismissal is appropriate only when the complaint does not give the defendant fair

notice of a legally cognizable claim and the grounds on which it rests. *See Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007). In considering whether the complaint is sufficient to state a claim, the court will take all material allegations as true and construe them in the light most favorable to the plaintiff. *See NL Indus., Inc. v. Kaplan*, 792 F.2d 896, 898 (9th Cir. 1986). The court, however, is not required to accept as true allegations that are merely conclusory, unwarranted deductions of fact, or unreasonable inferences. *See Sprewell v. Golden State Warriors*, 266 F.3d 979, 988 (9th Cir. 2001). A formulaic recitation of a cause of action with conclusory allegations is not sufficient; a plaintiff must plead facts showing that a violation is plausible, not just possible. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009) (citations omitted).

"Generally, a district court may not consider any material beyond the pleadings in ruling on a Rule 12(b)(6) motion. However, material which is properly submitted as part of the complaint may be considered." *Hal Roach Studios, Inc. v. Richard Feiner & Co.*, 896 F.2d 1542, 1555 n.19 (9th Cir. 1990) (citation omitted). Similarly, "documents whose contents are alleged in a complaint and whose authenticity no party questions, but which are not physically attached to the pleading, may be considered in ruling on a Rule 12(b)(6) motion to dismiss" without converting the motion to dismiss into a motion for summary judgment. *Branch v. Tunnell*, 14 F.3d 449, 454 (9th Cir. 1994). Moreover, under Federal Rule of Evidence 201, a court may take judicial notice of "matters of public record." *Mack*, 798 F.2d at 1282. Otherwise, if the district court considers materials outside of the pleadings, the motion to dismiss is converted into a motion for summary judgment. *See Arpin v. Santa Clara Valley Transp. Agency*, 261 F.3d 912, 925 (9th Cir. 2001).

III. ANALYSIS

Although the present case is in form a declaratory judgment action invoking the district court's original jurisdiction, the present case appears in substance to constitute an appeal of the Confirmation Order directly or a motion to clarify and enforce limitations on Defendant's

powers thereunder. If the former, the case must be filed as an appeal with the district court or the Ninth Circuit Bankruptcy Appellate Panel pursuant to 28 U.S.C. § 158. If the latter, Plaintiffs must direct their grievance directly to the bankruptcy judge in the Bankruptcy Case by appropriate motion. It is likely that the deadline to appeal the May 2009 Confirmation Order has long since expired and that Plaintiffs do not like their chances with the bankruptcy judge on a potential motion to clarify or compel. Hence, the present action. But the bankruptcy judge has jurisdiction to enter a declaratory judgment interpreting the Confirmation Order. *See In Re Optical Techs., Inc.*, 425 F.3d 1294, 1307–08 (11th Cir. 2005) (citing *Local Loan Co. v. Hunt*, 292 U.S. 234, 239 (1934)). Plaintiffs must appeal to the bankruptcy judge in the first instance for a clarification of the Confirmation Order, and if they wish to attack the Confirmation Order directly, then they must appeal it, assuming they have not waived the right to appeal by failure to object and have not slept on their rights to appeal after an objection.

Furthermore, a declaratory judgment action seeking a determination of whether certain assets are part of a bankruptcy estate or can be made so, whether a confirmation order is in conflict with ERISA, or any declaration requiring interpretation of a confirmation order and its construction with other laws is a "proceeding[] affecting the liquidation of the assets of the estate." The present action is therefore a core proceeding that must be heard in the bankruptcy court. *See* 11 U.S.C. § 157(b)(2)(O).

Plaintiffs argue in their supplemental brief that the Bankruptcy Court cannot constitutionally rule on ERISA matters without all parties' consent, and they go on to list all the ERISA issues they believe must be addressed to resolve the present case. However, the Bankruptcy Court may very well rule in such a way that ERISA issues need not be addressed. For example, it may rule purely under Title 11 that objections to the Plan, whether based on ERISA or not, have simply been waived. Or it may clarify ML Manager's powers under the Plan such that Plaintiffs are satisfied without having to resort to their arguments under ERISA.

CONCLUSION

IT IS HEREBY ORDERED that the case is REFERRED to the Hon. Randolph J. Haines of the Bankruptcy Court of this District pursuant to 28 U.S.C. § 157(a) and Local Rule 5011-1.

IT IS SO ORDERED.

Dated this 13th day of September, 2011.

ROBERT C. JONES
United States District Judge