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CLERK
U.S. BANKRUPTCY
DISTRICT OF ARIZONA

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re: MORTGAGES LTD., an Arizona corporation, Debtor.	In Proceedings Under Chapter 11 Case No. 2:08-bk-07465-RJH **ROBERT FURST'S OBJECTION TO MOTION TO SELL REAL PROPERTY FREE AND CLEAR OF LIENS, CLAIMS, ENCUMBRANCES AND INTERESTS** **Real Property located at 902 N. Signal Butte Rd. in Maricopa County, Arizona known as Adobe Meadows** **Hearing Date: November 22, 2011** **Hearing Time: 10:00 A.M.**

Robert G. Furst & Associates Ltd. Defined Benefit Pension Plan (the "Furst Pension Plan") hereby files its Objection to Motion to Sell Real Property Free and Clear of Liens, Claims, Encumbrances and Interests. The Furst Pension Plan is an interested party because it owns a tenancy in common interest in the subject property (the "VCB Property"). This Objection is supported by the Memorandum of Points and Authorities attached hereto.

1 **MEMORANDUM OF POINTS AND AUTHORITIES**

2 The Furst Pension Plan objects to ML Manager's proposed sale of the VCB Property (including the undivided tenancy in common interest owned by the Furst Pension Plan) because ML Manager does not have legal authority to bind the Furst Pension Plan in relation to the proposed sale. ML Manager did not seek prior instructions or authorization from the Furst Pension Plan prior to entering into the proposed sale of the VCB Property, as was required by *the particular agency agreement* between the Furst Pension Plan and Mortgages Ltd. Therefore, ML Manager's motion for approval of the sale should be denied.

11 **I. Background Facts**

The VCB Property consists of 32 fully-improved residential lots in a development known as Adobe Meadows in Mesa, Arizona. In 2007, Mortgages Ltd. loaned the developer/borrower approximately $6,400,000 to develop this project. In 2008, the borrower defaulted on the VCB loan, which was secured by the VCB Property. Foreclosure proceedings were initiated, and the investors obtained title to the VCB Property at the conclusion of the foreclosure proceedings.

ML Manager now wants to sell the entire project for $1,200,000. The VCB Property is owned by VCB Loan LLC, as to an undivided 73.581 interest, and the Non-Transferring Investors (including the Furst Pension Plan), as to an undivided 26.419% interest, all as **tenants in common**. ML Manager argues that it is the agent for each of the Non-Transferring Investors under various agency agreements, and, as their agent, wants to force them to participate in the sale. The Non-Transferring Investors, on the other hand, do not want to sell their 26.419% tenancy in common interest.

Mortgages Ltd., the Debtor, previously entered into various agency agreements with its investors relating to the servicing and collection of the loans owned by the investors. Under the confirmed plan of reorganization, Mortgages Ltd. assigned its rights under the various agency agreements to ML Manager, and it has the same agency rights that Mortgages Ltd. previously had.

This Motion is filed on behalf of the Furst Pension Plan only, and it addresses only *the particular agency agreement* between ML Manager and the Furst Pension Plan. ML Manager claims that, under this specific agency agreement, Mortgages Ltd. had unlimited discretion to act on behalf of the Furst Pension Plan, and that ML Manager, as its successor, has the same unlimited discretion. In fact, under the terms of *this particular agency agreement*, Mortgages Ltd. specifically agreed that its agency was limited to collection and servicing and that Mortgages Ltd. had no power or authority to modify loan terms or sell the property without first obtaining instructions or authorization from the Furst Pension Plan. In relation to the proposed sale of the VCB Property, ML Manager knew that the Furst Pension Plan opposed the proposed sale and never sought its instructions or authorization prior to entering into the proposed sale.

II. Legal Analysis

ML Manager does not have the authority or power to bind the Furst Pension Plan to the terms of the proposed sale against its wishes. The Furst Pension Plan, as a tenant in common, has well-defined property rights in the VCB Property under Arizona law, which must be respected by ML Manager.

A. Under the agency agreement, ML Manager does not have the authority to bind the Furst Pension Plan to the proposed sale without its prior consent.

The agency agreement,, which was executed between Mortgages Ltd. and the Furst Pension Plan, provided that, if Mortgages Ltd. wanted to modify loan terms or sell property acquired by foreclosure, Mortgages Ltd. had to obtain the prior consent of the Furst Pension Plan. This agreement is evidenced by, among other things, an e-mail from Robert Furst, as trustee of the Furst Pension Plan, to Chris Olson, the CFO of Mortgages Ltd., in the context of a 2004 loan default:

> I have received your letter, dated June 10, 2004, in which **you seek instructions in connection with the borrower's default.**
>
> You have my authority (1) to commence an immediate foreclosure action against the borrower and (2) to initiate any legal action against the borrower and/or guarantor that you deem necessary in your reasonable discretion. However, **I do not want you to "negotiate and enter into any extensions, modifications and/or forbearances of the Loan Document provisions," as described in Paragraph 3 of your letter. Moreover, I do not want you to compromise my claim in any manner.**
>
> Once the property is re-acquired through foreclosure, you may enter into any real estate brokerage contracts that you deem appropriate, provided that the net proceeds from the sale will provide me with a total return of my mortgage investment, plus 10% per annum. (Emphasis added)

Exhibit A.

If an evidentiary hearing was held, the Furst Pension Plan could offer an affidavit from James Cordello, former Vice President of Mortgages Ltd., confirming the terms of the subject agency agreement. In addition, there are numerous e-mails and other documents in the possession of ML Manager and ML Servicing Co. corroborating that the Furst Pension Plan insisted upon the aforementioned limitations.

The Court should also note that the Furst Pension Plan is not the first investor who has requested that the Court address (and honor) his/her specific agency agreement. On March 17, 2011, ML Manager and Sheldon Sternberg filed a Stipulation to Approve Settlement Between ML Manager and Sternberg Profit Sharing Plan (Exhibit B), and a Stipulated Order was entered on March 23, 2011 (Exhibit C) The Stipulation, which was signed by ML Manager, stated:

> Sternberg's agreements with Mortgages Ltd. were individually negotiated and included unique provisions not included in, or applicable to any other investor. Specifically, Sternberg entered into a "Master Agency" agreement with Mortgages Ltd. but negotiated an amendment to that agreement that, among other things, gave Sternberg the right to terminate its agency relationship with Mortgages Ltd., by providing notice.

Like Sternberg's Stipulated Order, the unique provisions of the Furst Pension Plan's agency agreement must also be recognized by ML Manager.

B. The Statement of Position of the Official Investors Committee was that the agency agreements were limited. and each one needed to be separately scrutinized.

Before Cathy Reece served as counsel for ML Manager, she was counsel for the Official Investors Committee (OIC) representing all of the investors, including the Furst Pension Plan. As the Court will remember, she worked side-by-side with Mr. Furst to oppose certain pre-confirmation actions taken by the Debtor (then under the control of Richard Feldheim) and argued repeatedly that the agency agreements were limited in scope. On November 7, 2008, she submitted a Supplement to Statement of Position on Authority and Agency by Investors Committee, which emphasized the following essential points regarding the scope of the various agency agreements:

1 First, according to the OIC and Cathy Reece, each investor did not grant the same
2 level of authority:
3
4 > [T]here are substantial differences in the various versions of the documents. Indeed, the Debtor essentially assumes that all of the operative agreements are identical, interchangeable and currently in force. This is simply not the case. As the court knows, there were thousands of investors. More important, the form of the documents changed over time, and the amount of authority or retractions on authority changed. Indeed, Robert Furst has already testified to this Court that the Debtor intentionally changed the form of the documents to provide more discretion and authority to the Debtor and that there were internal discussions that the Debtor did not have the requisite authority. The Debtor's argument, however, ignores these changes and essentially assumes every investor granted the same level of authority to the Debtor. As such, the Debtor's argument is not based on a correct assumption and ignores the reality.
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12 Exhibit D, page 2, lines 8-19.
13 Second, according to the OIC and Cathy Reece, some investors refused to grant
14 authority:
15
16 > [T]here are many investors who refused to grant the authority Debtor is seeking to employ. For example, Robert Furst indicated in his Response and in his testimony that most of the Subscription Agreements had a paragraph that allowed an investor to "withhold" discretion so that the Debtor had to obtain written consent for almost any action prior to execution . . . even modifications of the note. He testified that there were a number of investors who withheld discretion. This fact has been reluctantly acknowledged in open court by the Debtor.
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22 Exhibit D, page 3, lines 10-18.
23 This withholding of discretion by some investors has been a hotly debated topic
24 in this Court, but it has never been the subject of an evidentiary hearing because there
25 are no documents or e-mails supporting ML Manager's position that Mortgages Ltd.
26 has always had unlimited discretion to act on behalf of its investors. It has not. A
27 series of e-mails, which were sent on February 14, 2008 (Exhibit E), makes it
28

absolutely clear that Mortgages Ltd. and Scott Coles intentionally provided its investors with an option to withhold discretion from Mortgages Ltd., as agent, to modify or extend loans on their behalf. In such a case, if an investor did not consent to a modification or extension, the express agreement between the parties was that Mortgages Ltd. would purchase the investor's interest in order to obtain authorization to act (i.e., modify the loan). As explicitly stated in an e-mail to Bob Kant, Esq.:

> For the 10% of the investors who have not granted us discretion to extend or modify, Scott intends to buy them out of the loans in the event of a modification or extension.
>
> Exhibit E, page 2.

Moreover, in the first e-mail in Exhibit E, Scott Coles explicitly instructs Bob Kant, Esq., that he wants to change future subscriptions agreements, so that future investors cannot withhold discretion from Mortgages Ltd., but that Mortgages Ltd. that "was not amending the old." In other words, even in the face of mounting liquidity issues, Mortgages Ltd. intended to honor *its agreement*.

<u>Third</u>, according to the OIC and Cathy Reece, the investors did <u>not</u> grant unlimited discretion:

> As fully explained and set forth in [Robert Furst's Response], the Debtor is not authorized to administer, service and collect the loans on behalf of investors and the MP Funds. It is not granted unlimited and unfettered discretion. . .
>
> All of the activities and actions identified in the agreements for the agent to perform are related to and constrained by the purposes of administering, servicing and collecting the loans. Nowhere in the agreements are the powers or responsibilities given to the Debtor to undertake such activities as broad as subordination to new financing, granting a security interest in the investor's interest in the loan, release of liens on collateral without payment, reduction of principal because of the settlement of causes of actions arising from the

> Debtor's conduct, and such other broad activities contemplated by the Debtor. As explained in detail in the Furst Response, the language must be read in context within the sections and sentences and cannot be taken out of context. The Investor Committee asserts that when read in its entirety and in context the agreements provide the reasonable parameters set for a servicing and collection agent, such as the Debtor.

Exhibit D, page 6, line 2, through page 7, line 2.

In sum, the official position of the Official Investors Committee was that all investors granted only limited discretion, not unfettered discretion. But, even more important, it was the OIC position that each investor's agency must be read separately to determine its scope. As explained in Section A above, the Furst Pension Plan's agency agreement was extremely limited in scope, and ML Manager, as the successor to Mortgages Ltd., has no greater authority than Mortgages Ltd. did.

C. An evidentiary hearing would reveal that numerous other investors granted only servicing and collection authority to Mortgages Ltd.

Numerous other investors have contended that their particular agency agreement is similar to the Furst Pension Plan's agency agreement, as described in Section A above. Importantly, Elliott Pollack, the Chairman of the ML Manager Board, is one of them. Mr. Pollack was properly enraged when, in March 2008 (shortly before Scott Coles committed suicide), Mortgages Ltd. subordinated the existing 44th Street & Camelback loan to new third-party financing without first obtaining the permission of its investors, including him. Mr. Pollack demanded that his entire investment be returned to him, as he was contractually entitled to do under his particular agency agreement. The following e-mail was sent to Scott Coles on March 13, 2008:

> Elliott Pollack is very unhappy with the modification/extension of the 44th St. & Camelback loan. He believes that this is a "re-written" loan in which we have always given him the opportunity to receive the return of his entire investment (rather than continuing his investment). In this case, he wants the return of his $100,000 investment.

Scott Coles wrote the following e-mail to a company accountant later that day:

> Please have Mtg Ltd purchase his interest in the 44th St loan tomorrow . . . Please confirm this has been completed.

The Furst Pension Plan simply seeks to exercise the same control and same rights that Mr. Pollack exercised in 2008.

D. The Exit Financing has been paid off (or is virtually paid off).

The Court should be aware that Exit Financing was recently paid off (or is virtually paid off at the present time), and the investors have been promised by ML Manager that they would be given an opportunity to meet and discuss options to hold some or all of the remaining properties until market prices improve. In Newsletter No. 10 from ML Manager, it stated:

> Once the Exit Financing is repaid we expect that each loan will be given the opportunity to determine whether or not the investors desire to attempt to find a way to pay the allocated share of the costs of the bankruptcy and operating costs for the loan. Some of the loans that were not transferred into LLCs may be able to take advantage of this in the near term, however, we believe that it will be impractical for any of the Loan LLCs to consider alternatives for paying their share of costs until the exit financing is paid off.
>
> Once the interests of the Loan LLCs in the properties/loans are held free and clear we intend to ask each of the loans whether or not they would desire to attempt to find a way to pay their allocated share of the costs of the bankruptcy and operating costs without selling the properties/loans. This decision will be up to each of the Loan LLCs and will be made in accordance with the provisions of the Operating Agreements of the Loan LLCs and the Plan of Reorganization. Be advised that the Operating Agreements specifically provide that no member of an LLC is obligated to contribute additional moneys to any

> of the Loan LLCs. **Once the exit financing is paid off and the interests of the Loan LLCs are owned free and clear we will provide each of the loans the opportunity to determine their desired course of action. If the investors in a particular loan desire to raise money to pay their share of the allocated costs, they will be given the opportunity to do so. If the investors do not desire to attempt to obtain funds to pay off their share of the allocated costs or are unable to do so, the ML Manager LLC Board will continue to attempt to sell the property and the allocated costs will be deducted from the sales proceeds and the remaining balance will be paid to the investors.**
>
> This decision is undoubtedly several months away and many more details will be provided before such decisions will have to be made. We felt, however, it would be helpful at this time to make you aware of the intentions of the Board. (Emphasis added)

Although the discharge of the Exit Financing has no bearing on the proper interpretation of the Furst Pension Plan's agency agreement, the current status of the Exit Financing is presented to the Court, so that it will understand that honoring the terms of this particular agency agreement will not impede the Exit Financing in any way (just like the Court's recognition of Sheldon Sternberg's termination of his agency agreement did not result in any harm to the investors). Each investor's share of the Exit Financing has now been calculated, and the Non-Transferring Investors, including the Furst Pension Plan, are willing to pay their share right away, so the Exit Financing is a non-issue.

Conclusion

In conclusion, the Furst Pension Plan urges the Court to deny ML Manager's motion because it does not have authority to bind it in relation to the proposed sale of the VCB Property. If the proposed sale is allowed to go forward, ML Manager must purchase the Furst's Pension's interest in the VCB Property in order to acquire the necessary authority to sell the property.

1 DATED: November 15, 2011

ROBERT G. FURST & ASSOCIATES LTD.
DEFINED BENEFIT PENSION PLAN

Robert G. Furst
4201 North 57th Way
Phoenix, Arizona 85018
(602) 377-3702
Pro Per

Exhibit A

Jim Cordello

From: RGFURST@aol.com
Sent: Monday, June 21, 2004 2:28 PM
To: COlson@mtgltd.com
Cc: JCordello@mtgltd.com
Subject: *Default of Loan No. 819705 - Sonoran Family Communities*

Dear Chris:

I have received your letter, dated June 10, 2004, in which you seek instructions in connection with the borrower's default.

You have my authority (1) to commence an immediate foreclosure action against the borrower and (2) to initiate any legal action against the borrower and/or guarantor that you deem necessary in your reasonable discretion. However, I do not want you to "negotiate and enter into any extensions, modifications and/or forbearances of the Loan Document provisions," as described in Paragraph 3 of your letter. Moreover, I do not want you to compromise my claim in any manner.

Once the property is re-acquired through foreclosure, you may enter into any real estate brokerage contracts that you deem appropriate, provided that the net proceeds from the sale will provide me with a total return of my *mortgage investment*, plus 10% per annum.

Please e-mail me to acknowledge your receipt of this e-mail. I appreciate your prompt efforts to recoup my investment for me.

Best regards.

Bob Furst

Exhibit B

FENNEMORE CRAIG, P.C.
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Counsel for ML Manager LLC

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 **STIPULATION TO APPROVE SETTLEMENT BETWEEN ML MANAGER AND STERNBERG PROFIT SHARING PLAN**

Sternberg Profit Sharing Plan, by and through its Trustee, Sheldon Sternberg ("Sternberg") filed a Motion for Clarification of Order for Distribution of Proceeds (Docket 3073) (the "Sternberg Motion"). The Sternberg Motion sought clarification with regard to the Court's rulings and its effect on the allocation of costs and expenses to Sternberg. ML Manager LLC, ("ML Manager") and Sternberg have reached a settlement with respect to the allocation of costs and expenses to Sternberg and the relationship between Sternberg and ML Manager. Sternberg and ML Manager hereby stipulate to the entry of an Order an order approving the settlement between them. A copy of the settlement is attached as Exhibit "A".

The proposed settlement represents a compromise of the claims of both sides

1 reached after months of negotiations. ML Manager believes that this settlement is in the aid of the implementation of the Plan of Reorganization, in the best interest of all of the investors ML Manager represents, including all of the Loan LLC's and all pass-through investors. and is a valid exercise of its business judgment.

The settlement arises out of the unique circumstance and relationship between Sternberg and ML Manager in its capacity as the agent for pass-through investors. Sternberg has an interest in three loans. Sternberg has a 0.9524% interest in the Citrus 278 LLC loan, (b) a 1.3598% interest in the Foothills Plaza IV LLC loan and (c) a 2.4244% interest in the Northern 120 LLC loan ("Collectively the "Sternberg Loans").[1] As the Court will recall from prior briefing, Sternberg's agreements with Mortgages Ltd. were individually negotiated and included unique provisions not included in, or applicable to any other investor. Specifically, Sternberg entered into a "Master Agency" agreement with Mortgages Ltd., but negotiated an "amendment" to that agreement that, among other things, gave Sternberg the right to terminate its agency relationship with Mortgages Ltd. by providing notice.

Pursuant to the Plan of Reorganization approved by this Court, Mortgages Ltd.'s rights under the various agency agreements, including its rights with regard to Sternberg, were assigned to ML Manager. Effective February 7, 2010, Sternberg terminated its agency relationship with ML Manager. Since that time, there has been a dispute between ML Manager and Sternberg regarding the efficacy, effect and operation of that termination. ML Manager and Sternberg have now agreed to the attached settlement as a compromise of the accounting and part of the co-ownership issues of that dispute.

The settlement essentially provides that: (1) The parties recognize the efficacy of the termination of Sternberg's agency relationship with ML Manager effective February 7, 2010; (2) Sternberg agrees to pay its full share of all "general costs" and "loan specific

[1] The borrowers in all three of the Sternberg Loans have filed for bankruptcy.

1 costs" related to the Sternberg Loans that were incurred prior to February 7, 2010, which
2 the parties have agreed is $18,952.94; (3) Sternberg shall have no obligation to pay
3 "general costs" after the effective date of the termination; (4) Sternberg shall pay a
4 negotiated amount of "loan specific costs" associated with the Sternberg Loans incurred
5 from the termination date until the present; (5) Sternberg and ML Manager shall agree, if
6 possible, on Sternberg's share of "loan specific costs" going forward and will arbitrate any
7 dispute if an agreement cannot be reached; (6) If the calculation of any of the "general
8 costs" or "loan specific costs" is altered as a result of any of the pending appeals, or the
9 receipt of reimbursements from the liquidating trust, Sternberg will be entitled to an
10 adjustment in the amount it paid or owes; (7) ML Manager shall not act as Sternberg's
11 agent, but Sternberg and ML Manager will cooperate as provided for in the Settlement
12 Agreement with regard to the Trustee Sale procedure and Guarantee litigation for the
13 Sternberg Loans.[2]
14 WHEREFORE, ML Manager and Sternberg stipulate that the Court should enter an
15 order authorizing and approving the settlement described herein and attached hereto as
16 Exhibit A.
17 DATED this 17th day of March, 2011.
18 STERNBERG PROFIT SHARING PLAN FENNEMORE CRAIG, P.C.
19
20 By /s/ Sheldon Sternberg
21 Sheldon Sternberg
Trustee for the Sternberg Profit Sharing Plan

By /s/ Keith L. Hendricks
Cathy L. Reece
Keith L. Hendricks
22 Joshua T. Greer
Counsel for ML Manager LLC
23 CERTIFICATE OF SERVICE:
24
25 [2] Exhibit A provides the exact terms and conditions of the parties' agreements and controls their respective
26 obligations. This pleading is not intended to alter, expand, or amend the parties' obligations set forth in Exhibit A in any respect.

FENNEMORE CRAIG, P.C.
PHOENIX

2403879/28149.001

1 I hereby certify that on March 22, 2011, I electronically transmitted
2 the attached document to the Clerk's Office using the CM/ECF
3 system for filing and transmittal of a Notice of Electronic Filing to the
4 CM/ECF registrants.

5 COPY of the foregoing emailed this 22nd day of March, 2011 to the following:

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12 Counsel for the Liquidating Trust

13 */s/ L. Carol Smith*

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Exhibit C

IT IS HEREBY ADJUDGED and DECREED this is SO ORDERED.

The party obtaining this order is responsible for noticing it pursuant to Local Rule 9022-1.

Dated: March 23, 2011

Randolph J. Haines

RANDOLPH J. HAINES
U.S. Bankruptcy Judge

FENNEMORE CRAIG, P.C.
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IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re MORTGAGES LTD., Debtor.	Chapter 11 Case No. 2:08-bk-07465-RJH **STIPULATED ORDER APPROVING THE SETTLEMENT BETWEEN ML MANAGER AND STERNBERG PROFIT SHARING PLAN**

Pursuant to the authority provided in the Plan of Reorganization approved in this matter (Docket No. 1532) (the "Confirmed Plan"), and the Confirmation Order entered on May 20, 2009 (Docket No. 1755) (the "Confirmation Order"), ML Manager LLC ("ML Manager"), and the Sternberg Profit Sharing Plan, by and through its Trustee, Sheldon Sternberg ("Sternberg"), filed a Stipulation To Approve Settlement between ML Manager and Sternberg (the "Stipulation"). The Stipulation requests that the Court enter an order approving the settlement attached thereto as Exhibit A (the "Settlement").

Upon consideration of the Stipulation the Court finds and concludes as follows:

(a) This Court has jurisdiction to rule upon the issues presented in the Motion pursuant to, among other things, Section 9.1(e) of the Confirmed Plan;

(b) The Court has jurisdiction to enter this Order and authorize and approve the Settlement and the Motion;

(c) ML Manager has the authority to act on behalf of all the Loan LLCs created pursuant to the Reorganization Plan, and the pass-through investors who did not transfer their interest to the Loan LLCs to enter into and bind them to the Settlement;

(d) The Settlement and ML Manager's decision to enter into the Settlement reflects a reasonable compromise of the issues involved, are in the best interests of the parties, are supported by the best exercise of business judgment of ML Manager and are consistent with ML Manager's fiduciary duties and responsibilities.

(e) This is a Settlement of Sternberg's Motion for Clarification of Order for Distribution of Proceeds (Docket 3073) (the "Sternberg Motion") and the accounting issues referred to therein reserved by the Court for future determination. Besides ML Manager, no other parties have appeared or contested the Sternberg Motion. No further notice to any other party is required.

IT IS THEREFORE ORDERED THAT:

(1) The Stipulation is granted and the Settlement is approved.

ORDERED, SIGNED AND DATED AS STATED ABOVE.

Exhibit D

Fennemore Craig, P.C.
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Attorneys for Official Committee of Investors

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re MORTGAGES LTD., Debtor.	**Chapter 11** **Case No. 2:08-bk-07465-RJH** **SUPPLEMENT TO STATEMENT OF POSITION ON AUTHORITY AND AGENCY BY INVESTORS COMMITTEE** **Date: November 10, 2008** **Time: 1:00 p.m.**

The Official Committee of Investors ("Investors Committee") hereby files its Supplement to its Statement of Position on Authority and Agency. The Investors Committee incorporates and joins in the "Objection of Parties in Interest Eva Sperber-Porter, Litchfield Road Associates Limited Partnership, and Baseline & Val Vista Associates Limited Partnership to Debtor's Motion For Final Approval of DIP Financing with Stratera Portfolio Advisors re CenterPoint Project" and "Robert Furst's Response To Debtor's Statement of Position Regarding Debtor's Authority To Renegotiate the Terms of Certain Loans and To Enter Into Settlements."

I. THE DEBTOR IMPROPERLY TREATS ALL INVESTORS THE SAME

There are three fatal flaws with the Debtor's construction of the contractual grant of authority in the operative documents. First, the Debtor has failed to identify all of the investors, or at least all of the relevant forms of the operative documents involved in the particular loans at issue. Second, the Debtor ignores the fact that some investors refused

FENNEMORE CRAIG, P.C.
PHOENIX

to grant or revoked the very authority the Debtor is now attempting to exercise. Third, the Debtor ignores the fact that the Documents evolved over time and that earlier versions did not grant the same authority as the later versions. Because the Debtor is asking the Court to rule that it has authority to bind all investors, it must establish that all investors gave it the same authority. The Debtor cannot do this.

A. The Debtor Must Establish Foundation for all of the Relevant Versions of the Operative Documents

Debtor in its Statement of Position discusses some of the operative documents relevant to the Debtor's authority, but fails to address or even acknowledge that there are substantial differences in the various versions of the documents. Indeed, the Debtor essentially assumes that all of the operative documents are identical, interchangeable and currently in force. This is simply not the case. As the Court knows, there were thousands of investors. More important, the form of the documents changed over time, and the amount of authority or restrictions on authority changed. Indeed, Mr. Robert Furst has already testified by this Court that the Debtor intentionally changed the form of the documents to provide more discretion and authority to the Debtor and that there were internal discussions and concerns that the Debtor did not have the requisite authority. The Debtor's argument, however, ignores these changes and essentially assumes every investor granted the same level of authority to the Debtor. As such, the Debtor's argument is not based on a correct assumption and ignores the reality.

To prevail on an argument that it has the authority at issue, the Debtor must identify all of the different forms of the operative documents involved in the various loans at issue and establish that all of these different forms provided the authority asserted. The Debtor cannot ignore, for example, that there are multiple forms of the subscription agreements and agency agreements and that the different versions have material differences with respect to the Debtor's authority. Moreover, the Debtor cannot ignore

that the description of the authority evolved over time and that the earlier documents do not grant as much authority as the more recent documents. Instead of identifying the forms of all the investor agreements related to a particular loan or settlement, the Debtor takes a high altitude overview of the documents in general and argues from documents which have evolved and changed over time that it has authority. Without identifying all of the relevant forms of agreements, the Debtor has not met its burden and the Court cannot make a definitive decision that all of the investors impacted granted to the Debtor the authority at issue.

B. Debtor Cannot Ignore the Fact that Some Investors Refused to Grant the Debtor Authority

In addition to the general failure to meet its burden, there are many investors who refused to grant the authority the Debtor is seeking to employ. For example, Robert Furst indicated in his Response and in his testimony, that most of the Subscription Agreements had a paragraph that the allowed an investor to "withhold" discretion so that the Debtor had to obtain written consent for almost any action prior to execution, including placing the purchase of a note, or even modifications of the note. He testified that there were a number of investors who withheld discretion. This fact has been reluctantly acknowledged in open court by the Debtor.

Specifically, one common form of the Investor Subscription Agreements provides in paragraph 4(e):

> Unless authorization is withheld by so indicating below or in another written document to Mortgages Ltd. and MLS, the undersigned hereby authorizes Mortgages Ltd. to be named as the lender/payee/beneficiary as agent for the undersigned in the deed of trust or deeds of trust or mortgage or mortgages securing the Loan or Loans and other documentation relating to the Loans.

At paragraph 7, the same form of Subscription Agreement provides:

> **Grant of Discretion.** Until revoked at any time in writing, the undersigned hereby grants discretion to Mortgages Ltd.,

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> in its sole discretion, to select for purchase or sale the Loan or Loans with respect to which the undersigned acquires Participations. Without limiting the foregoing, the undersigned understands that his grant of discretion will give Mortgages Ltd. the authority, in its sole discretion, to make various determinations and take various actions with Loans with respect to Participations to be acquired, acquired [sic], or sold by the undersigned.

Finally, paragraph 8 indicated whether the investor "granted a power of attorney with respect to Mortgages Ltd. investment products." It is clear that some investors took this option. Mr. Furst testified as much. Further some of the investors have sent an objection to the Court indicating that they also withheld discretion, such as the letter objection. Moreover, these agreements allowed the investors the right to revoke the authority and other investors exercised this right. The Debtor does not address this provision and does not inform the Court who those investors are and what loan they are in. Instead of addressing the fact that some investors refused to give the Debtor or revoked the very authority the Debtor now seeks to implement and what such lack of authority means with regard to the proposed settlements, the Debtor simply ignores the issue. It cannot be ignored.

C. <u>The Amount of Authority Changed Over Time</u>

Mr. Furst testified that the documents changed over time, and the Debtor's interpretation of the authority granted also changed over time. Obviously, if the Debtor felt it was necessary to change the form of its documents to grant it more authority, this means that the prior version of the documents did not grant as much authority. An example is the changes to the documents related to Opportunity Fund 15. In the Private Offering Memorandum for Opportunity Fund 15, the Debtor, included in 2007 the following at page 14:

> Among other things, the Manager will have the right to revise the terms of outstanding Loans regardless of their performance, which may include increasing the principal amount, modifying the interest rate and payment terms, changing the collateral, adding fees and costs to the principal

1 balance, or substituting borrowers.

2 The Debtor also added this exact same language at page 62 where it was describing the
3 authority of the Debtor to manage the Funds. Because this was an addition to the form of
4 the documents, it is disingenuous to argue that all of the documents provide the exact
5 same level of authority.

6 Another example of incomplete disclosure by the Debtor relates to the Centerpoint
7 financing, although this argument is applicable to each and every deal. The first
8 Centerpoint note is dated March 20, 2007. The Debtor started selling fractional interests
9 in the note immediately thereafter and continued to sell pieces of the note until June of
10 2008. Some of the current holders of fractional interests in the Centerpoint note might
11 have signed the subscription agreement applicable in March 2007 and might not have
12 signed any later version. As a result to determine the authority issue as to that investor on
13 that loan, the Court would have to look at that specific applicable subscription agreement,
14 not the unsigned one used in 2008. Further an Investor might have withheld discretion in
15 March 2007 and not have changed the agreement. So again the Court would have to look
16 at the specific subscription agreement, not the unsigned one used in 2008. It is the
17 operative subscription agreement or agency agreement or other document which was
18 signed by the individual investor and which is still in effect that the Court needs to see and
19 which is important. Debtor has made no attempt to identify and provide this level of
20 detail to the Court for making this decision.

21 Finally, since no new loans were made after February 2008, it is unlikely that the
22 documents which the Debtor has given to the Court with changes effective February 2008
23 are even the applicable documents to be applied to an investor or the loan in question.
24 Without more disclosure and explanation, the Debtor is not presenting a proper question
25 to the Court in its pleading.

26

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II. DEBTOR IS OVERSTATING ITS AUTHORITY

As fully explained and set forth in the "Robert Furst's Response to Debtor's Statement of Position ..." filed with the Court October 8, 2008 ("Furst Response"), the Debtor is authorized to administer, service and collect the loans on behalf of the investors and the MP Funds. It was not granted unlimited and unfettered discretion.

As argued in previous pleadings, the notes are owned in undivided fractional interests by the investors and/or the Debtor. In some loans the Debtor may own a percentage of the loan, but in others the Debtor owns zero percent. The Debtor has not provided the Court with a copy of any of the notes to be modified along with the endorsements made out to the investors. The point is, however, that the Debtor does not own the interest in the note, it only services that interest. In other words, the Debtor is not playing with its own money, it is attempting to use its status as an agent to make modifications to the investor's property (the notes and deeds of trust). Debtor claims that it has the right to do this because the investors gave it authority to do so. Even under the documents relied upon by the Debtor, however, the grant of authority is not so unlimited and broad.

All the activities and actions identified in the agreements for the agent to perform are related to and are constrained by the purposes of administering, servicing and collecting the loans. Nowhere in the agreements are the powers or responsibilities given to the Debtor to undertake such activities as broad as subordination to new financing, granting a security interest in the investor's interest in the loan, release of liens on collateral without payment, reduction of principal because of the settlement of causes of actions arising from the Debtor's conduct, and other such broad activities contemplated by the Debtor. As explained in detail in the Furst Response, the language must be read in context within the sections and sentences and cannot be taken out of context. The Investors Committee asserts that when read in its entirety and in context the agreements

1 provide the reasonable parameters set for a servicing and collection agent, such as the
2 Debtor.

3 **III. <u>THE AGENCY AGREEMENTS ARE TO BE NARROWLY AND STRICTLY CONSTRUED AGAINST DEBTOR</u>**

4 Contrary to the Debtor's position, silence in the agreements should not and do not
5 constitute authority to be able to make all the decisions without the consent of the
6 investors, or constitute a grant of unlimited and unfettered discretion.

7 It is well established that courts must strictly construe the grant of authority in a
8 power of attorney. *Lightning Delivery Co. v. Matteson*, 45 Ariz. 92, 97 39 P.2d 938, 941
9 (1935) ("It must be kept in mind that under all the authorities powers of attorney should
10 be strictly construed and that the courts should never by construction extend the power
11 they confer beyond that given in terms, or is absolutely necessary to carry that conferred
12 into effect"); *Archbold v. Reifenrath*, 744 N.W.2d 701, 708 (Neb. 2008) ("Powers of
13 attorney are by necessity strictly construed, and broad encompassing grants of power are
14 to be discounted"). In this case, while the investor signed a subscription agreement
15 adopting the agency agreement or operating agreement which would have been attached
16 to a lengthy private offering memorandum and granting a power of attorney, the Debtor
17 signed the agency agreement or operating agreement on behalf of the investor. As such,
18 the scope of the Debtor's power of attorney or agency powers must be strictly and
19 narrowly construed.

20 Further, it is black letter law that any ambiguities in a contract are to be construed
21 against the drafter. *See, e.g., United California Bank v. Prudential Ins. Co. of America*,
22 140 Ariz. 238, 260, 681 P.2d 390, 412 (App. 1983) ("even if Prudential were able to
23 demonstrate that the incorporation clause of the commitment letter which it drafted is
24 ambiguous, such a demonstration would be self-defeating because ambiguities will be
25 construed against the drafter"). This rule of construction carries even greater weight in
26

1 this case, because as noted above, the Debtor drafted the agreements, served in multiple
2 capacities in the agreements and signed agreements on behalf of the principals. The
3 Investors did not even sign the agency agreements. The Debtor exercising the power of
4 attorney signed on their behalf pursuant to a subscription agreement.

5 The agreements are also contracts of adhesion that contain unreasonable and
6 therefore unenforceable terms. "[A] contract of adhesion signifies a standardized
7 contract, which, imposed and drafted by the party of superior bargaining strength,
8 relegates to the subscribing party only the opportunity to adhere to the contract or to reject
9 it." *Huff v. Bekins Moving & Storage Co.*, 145 Ariz. 496, 498, 702 P.2d 1341, 1343 (App.
10 1985). Generally speaking, "there are two judicially imposed limitations on the
11 enforcement of adhesion contracts or provisions thereof. The first is that such a contract
12 or provision which does not fall within the reasonable expectations of the weaker or
13 'adhering' party will not be enforced against him. The second-a principle of equity
14 applicable to all contracts generally-is that a contract or provision, even if consistent with
15 the reasonable expectations of the parties, will be denied enforcement if, considered in its
16 context, it is unduly oppressive or 'unconscionable'." *Id.* (citations and quotations
17 omitted). The Debtor has not shown, and cannot show, that there is any provision of the
18 agreements that gave the Investors the reasonable expectation that the Debtor was entitled
19 to enter into these broad of settlements or transactions on behalf of the Investors that
20 permitted the Debtor's interests in continuing in business over the Investors' property
21 interests or that allowed the Debtor to settle causes of actions against it for its own
22 misconduct at the expense of the Investors. In this case, there is no mention in any of the
23 documents that the principal amount of loans might be forgiven, that that loans might be
24 subordinated to third parties, that the personal guarantees might be released, that separate
25 loans might be combined, or many of the other things the Debtor is now trying to do.
26 Rather than interpreting general phrases in the agreements broadly in favor of Debtor, all

terms need to be narrowly and strictly construed in favor of the investors.

IV. ALLOWING THE DEBTOR TO EFFECTUATE THE SETTLEMENTS WOULD IN SOME SITUATIONS AMOUNT TO A SUB ROSA OR CREEPING PLAN

The Debtor argues that the agreements have to be broadly construed or the results will be "disastrous" and "unworkable" and that there is no reasonable alternative. On the contrary, the reasonable alternative is that the Debtor needs to obtain the consent of the investors before any such onerous and drastic changes can be made in the Loans. More important, this argument simply demonstrates that the Debtor is attempting to resolve the significant outstanding issues in its favor before being obligated to fulfill the requirements of presenting a plan of reorganization and obtaining approval.

It is well established that a settlement which has the effect of dictating the terms of the debtor's plan of reorganization prior to the confirmation process cannot not be approved. *See In re Braniff*, 700 F.2d 935, 940 (5th Cir.1983) ("The debtor and the bankruptcy court should not be able to short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan sub rosa ..."); *In re Iridium*, 2005 WL 756900 at *7 ("the trustee *169 is not authorized to enter into a settlement if it results into a de facto or sub rosa plan of reorganization"); *In re Crowthers McCall Pattern, Inc.*, 114 B.R. 877, 887 (Bankr.S.D.N.Y.1990) ("A transaction which would effect a lock-up of the terms of a plan will not be permitted").

The *Braniff* Court, for instance, refused to approve two settlements by the debtor that purported to resolve disputes with certain of its secured and unsecured creditors. Those settlements involved a complex transfer of cash, aircraft, equipment, leases and landing slots in exchange for travel scrip, notes and a profit participation in the purchaser. *Braniff*, 700 F.2d at 938. The proposed agreements would have required the debtor to distribute travel scrip in any plan of reorganization, a requirement the Fifth Circuit declared impermissibly "had the practical effect of dictating some of the terms of any

1 future reorganization plan." *Id.* at 939-40. As that court recognized, "[t]he debtor and the
2 Bankruptcy Court should not be able to short circuit the requirements of chapter 11 for
3 confirmation of a reorganization plan" by establishing the essential terms of a plan in
4 connection with a separate agreement. *Id.* at 940.

5 Following *Braniff*, courts have refused to condone settlement agreements that do
6 far less than Debtor's sweeping proposals to modify the protections otherwise afforded its
7 investors. In the *Continental Air Lines* case, for instance, the bankruptcy court approved
8 two of the debtor's post-petition aircraft leases. Creditors appealed, contending that the
9 proposed leases "represent pieces of a creeping plan of reorganization" and that they
10 "could have defeated a plan of reorganization containing the leases." 780 F.2d at 1227,
11 1228. The Fifth Circuit vacated the bankruptcy court's decision, noting that the
12 protections afforded by the confirmation process "might become meaningless" if they
13 could be avoided piecemeal through agreements reached prior to confirmation. *Id.* at
14 1227-28 ("Undertaking reorganization piecemeal pursuant to § 363(b) should not deny
15 creditors the protection they would receive if the proposals were first raised in the
16 reorganization plan").

17 Here, Debtor's attempt to summarily and significantly modify millions of dollars in
18 loans is beyond the pale. And while the investors may eventually vote on a plan, that
19 right will be meaningless if Debtor effectuates pre-plan settlements that irrevocably limit
20 the options and assets available at the time of confirmation. For example, the proposed
21 settlements ask the Court to approve the transformation of debt into equity, subordinate
22 first and second liens to other loans, delegate agency responsibilities (such as foreclosure)
23 to other entities, subject the investors to direct contractual liability to other lenders,
24 consolidate the loans for several borrowers and from many investors into a single loan,
25 and assume that future loans and subordination will be forthcoming or approved in a plan.
26 As such, many aspects of these settlements clearly anticipate, dictate and restrict plans of

1 reorganization. Debtor's settlement proposals are little more than an attempted "end run"
2 around the protections afforded to the investors under the Bankruptcy Code, and as they
3 are *sub rosa*, they cannot be approved.

4 **V. MANY OF THE SETTLEMENTS VIOLATE THE OPERATING AGREEMENTS OF THE FUNDS, AND EXCEED THE DEBTOR'S**
5 **RIGHTS AS MANAGER**

6 The Operating Agreement for each of the Opportunity Funds (the "Funds") states
7 an express purpose of the Fund and then requires that a 75% vote of the members to
8 change that purpose, or to amend the Operating Agreement. The settlements the Debtors
9 propose violate these restrictions without the required vote.

10 Section 2.3 of the Operating Agreement provides that the purpose of the LLC is to:

> 11 fund loans to borrowers or own interests in new or existing loans from third parties and to collect principal and interest
> 12 payments due thereunder, or to the extent not received, pursue collection or realize on any collateral; for such loan, including
> 13 the ownership and operation of any such collateral (collectively, "Loans", and individually, a "Loan").

14 In other words, the purpose of the Fund is to make and collect on loans. Then Section 6.4
15 provides that without the affirmative vote of 75% vote of the Members that the Manager
16 shall not in subsection (a) amend the Operating Agreement, in subsection (c) change "any
17 of the [LLCs] purposes as set forth in Section 2.3", in subsection (d) "us[e] [LLCs] funds
18 or capital other for a business purpose of [the LLC] as set forth in Section 2.3", and in
19 subsection (e) "commingling any Company funds or capital with the funds of any other
20 Person". To the extent that any of the settlement changes debt to equity, combines
21 multiple loans into one loan, or uses money for any purpose other than a loan, it violates
22 the agreement and exceeds the Debtor's authority.

23 In another section of the Operating Agreement there are express "Limitations on
24 the Manager". Section 6.5 requires the Manager to acquire and manage all Loans (which
25 was defined in Section 2.3) of the LLC subject to certain policies and criteria, expressly
26 that "All Loans shall be secured by a first or second lien encumbrance on real property

(and improvements if any) and such other collateral as the Manager deems appropriate to fully secure the Loan." The Manager cannot release collateral or liens if the loan is not fully secured or put the security in anything less than a second position. Several of the proposed settlements violate this restriction by either changing debt to equity or simply putting the investors into a third or fourth position.

Finally, some of the settlements delegate to other entities obligations that are exclusive the Manager. For example, Section 6.2 indicates that certain obligations are exclusive to the Manager, including the obligation to "dispose of any real property" and Section 6.3 provides that the Manager is obligated to "perform all normal business functions" of the Fund. Nevertheless, some of the settlements include a delegation of things such as foreclosure responsibilities to other entities.

Consequently, to the extent, any of the settlements remove liens, convert debt to equity, combine loans, delegate foreclosure obligations to third parties, or put the investors in a third position or worse, among other things, those actions would be in violation of the Operating Agreement would not be permitted.

VI. THE DEBTOR'S CONFLICT OF INTEREST VITIATES ITS AUTHORITY

In agreeing to settlements in order to eliminate its own liability, the Debtor, which is acting in the capacity of an agent, has a conflict of interest with the interest of the investors, its principal. The law is clear. Such a situation vitiates the agent's authority.

An agent has a fiduciary duty of loyalty to his or her principal and is bound to exercise the utmost good faith in his or her conduct of agency. *Mallamo v. Hartman*, 70 Ariz. 294, 298, 219 P.2d 1039, 1041 (1950). According to Arizona law, "[v]iolating the duty of loyalty, or failing to disclose adverse interest, ***voids the agency relationship***." *State v. DiGiulio*, 172 Ariz. 156, 160, 835 P.2d 488, 492 (App. 1992) (emphasis added). Voiding the agency relationship also voids any acts undertaken by the agent on behalf of the principal. *See id.*; *see also In re JLJ Inc.*, 988 F.2d 1112, 1116 (11th Cir. 1993)

1 (applying Alabama law) ("[T]he general rule is that an agent's act against the interest of
2 the principal is void ....").

3 The general rule that acts taken where there is a conflict of interest between the
4 agent and the principal voids the relationship is also set forth by the *Restatement of*
5 *Agency*. The *Restatement (Second) of Agency*, § 112 states that "Unless otherwise agreed,
6 the authority of an agent terminates if, without knowledge of the principal, he acquires
7 adverse interests or if he is otherwise guilty of a serious breach of loyalty to the
8 principal." Here, there is absolutely no evidence or document that provides that the
9 Debtor may compromise the investor's property in order to settle the claims against itself.
10 The Debtor is proposing settlements in order to, or at least have the effect of eliminating
11 substantial claims against the Debtor. The primary, if not sole consideration that the
12 Debtor is offering for these releases is the compromise of the investor's property. Under
13 the *Restatement* and other well established law, such a conflict of interest voids the
14 agency relationship between the Debtor and the investors. This means that the Debtor
15 simply does not have the authority to use the investors' property as consideration to
16 eliminate claims against it.

17 Moreover, the *Restatement* also provides that, "an agent's actual authority
18 terminates .... (2) upon the occurrence of circumstances on the basis of which the agent
19 should reasonably conclude that the principal no longer would assent to the agent's taking
20 action on the principal's behalf." *Restatement (Third) Agency*, § 3.09. Here, the
21 investors, through the Court appointed Committee, and through dozens and dozens of
22 objections have made it clear that they do not assent to the actions taken by the Debtor.
23 As such, the actual evidence shows that the investors, or at least many of them, no longer
24 assent to the Debtor's actions. As to these investors, the Debtor simply no longer has the
25 authority to compromise their property. Moreover, the evidence shows that it is
26 objectively unreasonable that the investors would continue to consent to the Debtor's

actions in compromising their property in order to obtain a release for itself.

Finally, the conflict constitutes a change of circumstances upon which the Debtor should reasonably know that the investors no longer consent to the Debtor acting on their behalf. *Restatement (Second) of Agency* § 108 provides that the authority of an agent terminates or is suspended when the agent has notice of the happening of an event or of a change in circumstances from which he should reasonably infer that the principal does not consent to the further exercise of authority or would not consent if he knew the facts. *Comment a* to this section provides if the agent has notice or he should realize that the principal would not wish him to act, the authority terminates. Section 109 covers Change in value or Business Conditions. It provides: "The authority of an agent terminates or is suspended when he has notice of a change in value of the subject matter or a change in business conditions from which he should infer that the principal, if he knew of it, would not consent to the further exercise of the authority." *Comment c* provides that "a business agent is subject to a duty to the principal to use care and skill in ascertaining business conditions, and he is not authorized to do the directed act, unless his orders are peremptory, if he reasonably should realize in light of facts which he would ascertain by the use of the skill which he has or purports to have that the principal would not desire him to act if the facts were known."

This concept is reinforced in the *Restatement (Third) of Agency*. Section 3.06 – Termination of Actual Authority – provides that "[a]n agent's actual authority may be terminated by .... (4) an agreement between the agent and the principal or the occurrence of circumstances on the basis of which the agent should reasonably conclude that the principal no longer would assent to the agent's taking action on the principal's behalf ...." *Comment b.* – provides insight that is directly on point. It states: "For example, the agent may become insolvent and have notice that it is important to the principal to be represented by a solvent agent. The agent may lose capacity to bind itself by a contract or

1 to become subject to other obligations and have notice that it is important to the principal
2 that the agent retain such capacity." In other words, the Debtor cannot simply ignore the
3 investors' wishes and continue with settlements that the investors reject when there are
4 such fundamental changes. *See also Restatement (Third) of Agency* § 3.09. (termination
5 by occurrence of changed circumstances).

6 The disloyalty of the Debtor also vitiates the agency authority. Section 112 of
7 *Restatement (Second) of Agency* provides that "[u]nless otherwise agreed, the authority of
8 an agent terminates if, without knowledge of the principal, he acquires adverse interests or
9 if he is otherwise guilty of a serious breach of loyalty to the principal." There was never
10 any agreement that the Debtor could use the loans to settle claims against the Debtor.
11 *Comment b* makes it clear that agents are appointed to forward the principal's interest, and
12 when the agent ceases to do this and prefers his own or another's interests it terminates his
13 authority.

14 Finally, because the Debtor's bankruptcy, by itself, terminates the Debtor's
15 authority to act on behalf of the investors where the investors are disadvantaged because
16 the Debtor's credit. Section 113 of the *Restatement (Second) of Agency* – Bankruptcy of
17 Agent, provides:

18 > The bankruptcy or insolvency of an agent terminates his
19 > authority to conduct transactions in which the state of his
> credit would so affect the interests of the principal that the
20 > agent should infer that the principal, if he knew the facts,
> would not consent to the further exercise of the authority.

21 In this case, the Debtor's bankruptcy or insolvency is the primary or inextricably
22 intertwined with the settlements. Primary to many of the claims being settled is the
23 Debtor's inability to fund loan commitments. As such, the Debtor's insolvency has now
24 placed the investors in a position that their property is being compromised. *See also*
25 *Restatement (Third) of Agency*, § 3.09, *cmt. B.* In this situation, the Debtor's bankruptcy
26 terminates its authority.

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VII. THE AGENCY AGREEMENTS ARE EXECUTORY CONTRACTS AND MAY BE TERMINATED

Most courts, including the Ninth Circuit, have adopted Professor Vern Countryman's definition of an executory contract that a contract is executory if the "obligations of both parties are so far unperformed that the failure of either party to complete performance would constitute a material breach and thus excuse the performance of the other." *Commercial Union Ins. Co. v. Texscan Corp. (In re Texscan Corp.)*, 976 F.2d 1269, 1272 (9th Cir. 1992).

A. The Agreements Are Executory

To determine whether failure to perform the remaining obligations would constitute a material breach, courts need to consider contract principles under the relevant non-bankruptcy law. *Enterprise Energy Corp. v. U.S. (In re Columbia Gas Sys. Inc.)*, 50 F.3d 233, 239-40 n.10 (3d Cir. 1995). The Court in *Hall v. Perry (In re Cochise College Park, Inc.)*, 703 F.2d 1339 (9th Cir. 1983), noted that "a bankruptcy court should determine whether one of the parties' failure to perform its remaining obligations would give rise to a 'material breach' excusing performance by [the] other party under the contract law applicable to the contract...." *Id.* at 1348, n.4.

There are numerous provisions in the Agency Agreements that set forth obligations for the Debtor, but there are also several provisions with continuing investor obligations and with remedies in the event of a default, including the confidentiality provisions in Section 6, the indemnity provisions in Section 4, the obligation to execute documents in Section 5 and the obligations to reimburse for expenses, among others. In the Operating Agreements there are several provisions with continuing member obligations, including the tax indemnity obligation in Section 8 and the meeting and voting requirements in Section 6, among others, and with remedies in the event of a default, such as Section 7.6. Because a breach of these obligations by an individual investor would excuse the Debtor

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1 from performing under the agreements vis-à-vis that investor, those agreements are
2 executory. *See, e.g., Broyhill v. DeLuca (In re DeLuca)*, 194 B.R. 65 (Bankr. E.D. Va.
3 1996); *In re Daughtery Constr. Inc.*, 188 B.R. 607 (Bankr. D. Neb. 1995). Because the
4 agency relationship is executory in nature, the filing of the bankruptcy by the Debtor has
5 the effect of terminating the agency relationship and prevents Debtor from assuming the
6 agreements under Section 365(c) or (e).

7 **B. Under Section 365(c) the Agreements Cannot be Assumed**

8 Although executory, the Agency Agreements cannot be assumed because they are
9 personal and confidential in nature and under applicable non-bankruptcy law are
10 nondelegable. *See Knudsen v. Torrington Co.*, 254 F.2d 283, 286 (2d Cir. 1958).

11 **C. Under Section 365(e) the Agreements Are Not Assumable**

12 Although executory, the Operating Agreements also cannot be assumed because
13 they contain clauses providing for their termination upon the Debtor's bankruptcy filing
14 (*See* Funds' Operating Agreement, at § 7.3(a), and Article XII Definition of Bankruptcy.)
15 Although so-called *ipso facto* clauses are generally not enforceable in bankruptcy law,
16 Section 365(e)(2)(A) provides for their enforceability where:

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> (A) (i) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to the trustee or to an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and
>
> (ii) such party does not consent to such assumption or assignment....

22 As demonstrated above, applicable law here allows the investors to terminate the agency
23 relationship. Therefore, the Operating Agreement allows the termination of the Debtor's
24 rights as Manager, and the executory contracts cannot be assumed.

25 **VIII. ADDITIONAL ISSUES RAISED BY THE COURT**

26 The Court has asked the parties to brief some additional issues with regard to

1 authority such as the applicability of Section 363(h), and law regarding participation
2 agreements.

3 **A. Section 363(h) Is Not Helpful Or Applicable**

4 The Court has inquired about the application of Section 363(h) to this case. In
5 short, it is not applicable. The assets implicated in all of the settlements that are in
6 question are notes and deeds of trust, not real property. The concept of "tenant in
7 common" is applicable to real property. *See, e.g.*, A.R.S. § 12-1252. There is no
8 authority for the proposition that tenancy in common or Section 363(h) even applies to
9 fractionalized interests in promissory notes and deeds of trust. Moreover, the notes and
10 deeds of trust are not even property of the bankruptcy estate. As such, the authorization in
11 section 363(h) to for a Debtor to sale real property that is the subject of a co-tenancy is not
12 applicable. Furthermore, section 363(h) permits the "sale" of the property. None of the
13 settlements are seeking a sale of the promissory notes and deeds of trust. Because nothing
14 other than the "sale" of co-owned real property is authorized by section 363 (h), it is
15 simply not applicable.

16 **B. Participation Cases Are Not Helpful**

17 The Court also asked if "participation" cases are applicable and again the case law
18 in this area is almost nonexistent. The case cited by the Debtor is not applicable to our
19 situation. There are many cases regarding participation agreement between banks or
20 insurance companies in the context of excess insurance, but these cases simply construe
21 the participation agreements at issue. The Investors' Committee could find no additional
22 propositions that were relevant or persuasive for this situation. In short it is the terms of
23 the specific documents at issue and the general agency principles that determine the extent
24 and scope of authority of an agent in conjunction with applicable bankruptcy law, as
25 indicated above, that governs in this case.

26

IX. CONCLUSION

In addition to the previous briefing provided to the Court and the arguments and facts from the briefs incorporated herein, the Debtor's claims for authority to conclude the settlement agreements at issue fails. The Debtor improperly assumes that it has the same authority to act for all investors. The Debtor overstates the authority granted to it by the operative documents. The Debtor's authority has been vitiated by the clear conflict of interest, and its bankruptcy. The Debtor does not have authority to take the actions under the Bankruptcy Code. Finally, the additional issues raised by the Court do not provide authority for the Debtor's actions. Accordingly, the Investors Committee submits it position on the authority and agency issues but reserves the right to supplement or modify this pleading further.

DATED this 7th day of November, 2008.

FENNEMORE CRAIG, P.C.

By /s/ Cathy L. Reece (005932)
Cathy L. Reece
Keith L. Hendricks
Attorneys for the Official Committee of Investors

COPY of the foregoing emailed or mailed this 7th day of November, 2008 to the parties on the attached Service List.

/s/ Susan Stanczak-Ingram

2125694.1

Exhibit E

Robert Furst

From: Scott M Coles
Sent: Thursday, February 14, 2008 3:04 PM
To: 'kantr@gtlaw.com'
Cc: Robert Furst
Subject: RE: Mortgages Ltd.

Bob,

I do not want them to have discretion. If they question my authority, they do not have to invest with us. This change has to do with selling pass throughs going forward and not amending the old. The percentage of people that checked no discretion was under 5%. I do not want this option in the changes that we have requested of you.

Thank you.

Scott M Coles
President/CEO

SColes@mtgltd.com
P: 602.287.3031
C: 602.359.7162
F: 602.287.3075

MortgagesLTD.
55 E Thomas Rd
Phoenix AZ, 85012

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From: kantr@gtlaw.com [mailto:kantr@gtlaw.com]
Sent: Thursday, February 14, 2008 2:40 PM
To: Robert Furst
Cc: Scott M Coles; GarciaB@gtlaw.com
Subject: RE: Mortgages Ltd.

Bob, I really believe we need to think things through before changing everything. A lot of thought went into your documents. For example, take a look at section 5 of the New Investor Subscription Agreement, which allows you to all the things you want to do. There was no discretion. That was a new provision we added more than a year ago. I believe there was concern about adding it to the Existing Investor Account Agreement. That is the provision I would add to all the documents rather than getting rid of the discretion. It just plays better and is better language. It is already in your new POM so I think you can continue to use. You should check and see how many people signed that.

From: Robert Furst [mailto:rfurst@mtgltd.com]
Sent: Thursday, February 14, 2008 2:23 PM
To: Kant, Robert S. (Shld-Phx-CP)
Subject: RE: Mortgages Ltd.

I just spoke to Scott, and he wants to make sure that Mortgages Ltd. has this discretion with new investors going forward. With regard to existing investors, more than 90% of the investors have already granted us this discretion anyway. For the 10% of the investors who have not granted us discretion to extend and modify, Scott intends to buy them out of the loans in the event of an extension or modification.

From: kantr@gtlaw.com [mailto:kantr@gtlaw.com]
Sent: Thursday, February 14, 2008 1:13 PM
To: Robert Furst
Cc: GarciaB@gtlaw.com
Subject: RE: Mortgages Ltd.

The problem is that really will not work because of the fact that most people will have already signed the early one. How are you going to solve that

---

From: Robert Furst [mailto:rfurst@mtgltd.com]
Sent: Thursday, February 14, 2008 1:09 PM
To: Kant, Robert S. (Shld-Phx-CP)
Cc: Scott M Coles
Subject: Mortgages Ltd.

Hi Bob:

Scott Coles would like you to amend the Pass-Through POM, the Agency Agreement, the Existing Investor Account Agreement, the New Investor Subscription Agreement and all other related documents to specifically grant Mortgages Ltd. the discretion to extend and modify loan agreements. With respect to the Existing Investor Account Agreement and the New Investor Subscription Agreement, Scott does not want the investors to have the choice any longer of either granting or withholding such discretion.

If you have any questions, please feel free to call me.

Best regards.

Robert Furst
Senior Managing Director

P: 602.277.5626
C: 602.377.3702
F: 602.287.3076

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