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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 **REPLY IN SUPPORT OF ROBERT FURST'S MOTION FOR DECLARATION OF RIGHTS UNDER THE PLAN OF REORGANIZATION FOR THE PASS-THROUGH INVESTORS IN THE VISTOSO LOANS** **Hearing Date: April 17, 2012** **Hearing Time: 1:30 P.M.**

Robert G. Furst hereby files his Reply in Support of Motion for Declaration of Rights under the Plan of Reorganization for the Pass-Through Investors in the Vistoso Loans.[1] As explained below, there are no procedural or substantive reasons why the Motion should not be granted.

[1] The Court may remember that Mr. Furst filed a similar motion (Docket No. 3387) but withdrew it without prejudice after Cathy Reece offered to negotiate with him in good faith about the issues in question. The parties met and some progress was made, but issues remain. This Motion is filed to seek resolution of those remaining issues.

The Exit Financing has now been paid in full, and the vast majority of the Vistoso investors want to hold the Vistoso properties,[2] which are the two "crown jewels" of the ML real estate portfolio, until the real estate market recovers. There is good reason why the Vistoso investors want to hold these two properties: **Conley Wolfswinkel, the developer/borrower, believes that the investors can recoup their entire investment from these properties if they are permitted to hold them for just another 18-24 months.**

Until now, ML Manager has repeatedly stated that, once the Exit Financing has been repaid to the Exit Financier, the investors would be given the opportunity to pay their allocated share of the Exit Financing *out of their own pockets* (rather than from the proceeds of additional distressed sales), so that they could continue to own some properties until it is a more opportune time to sell. Unfortunately, however, ML Manager is now reneging. ML Manager now claims that it has no *fiduciary duty* whatsoever to schedule an investor meeting so that the investors can freely and open discuss their options. Moreover, ML Manager now claims that it has no *fiduciary duty* to, at a minimum, provide investor contact information to all of the investors, so that they can communicate amongst themselves and make a meaningful decision before they vote on future distressed sales. In short, ML Manager believes that only ML Manager has the right to communicate with investors before they vote.

By staking this position, it is glaringly apparent that ML Manager wants to prevent a large investor vote at all costs. ML Manager is thrilled that only 5-10% of the investors are now voting, and ML Manager wants to keep it that way. ML Manager recognizes that the

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[2] The Vistoso investors do not yet own the Vistoso properties because the foreclosure sales have not occurred. Mr. Furst has filed this Motion so that the parties will know the ground

Vistoso investors will approve any upcoming distressed sale ***only if*** ML Manager can limit the voter turnout by whatever means possible. By limiting investor interaction, ML Manager believes that it control the outcome of the elections.

It is for that reason --- to ensure a fair and honest vote --- that the Motion should be granted. ML Manager's position is dead wrong; it is contrary to the intent of the Confirmed Plan, which was intended to create an investor democracy, not a managerial dictatorship; and it is contrary to Arizona fiduciary law.

1. By Its Own Admission, ML Manager Has a Fiduciary Duty to Schedule an Investor Meeting to Discuss Future Property Sales Not Necessitated by Exit Financing Concerns.

Glaringly missing from ML Manager's Response is any reference to its prior newsletter, in which it promised the ML investors that, once the Exit Financing was repaid, they would be given the opportunity 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." Specifically, ML Manager, in Newsletter No. 10, 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

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rules before the properties are acquired by foreclosure and then re-marketed.

> 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)

The first investors to take advantage of this right were the Pass-Through Investors in the GP Properties Loan, who (a) paid their allocable share of the Exit Financing *out of their own pockets* (rather than from the proceeds of a distressed sale), (b) terminated their agency agreements with ML Manager, (c) took over the management of the property, and (d) now hold the property waiting for a more opportune time to sell.

ML Manager vigorously opposed this proposal when it was initially made by Mr. Furst. ML Manager initially argued that, even if 100% of the investors in a loan wanted to pay their share of the Exit Financing costs and terminate their agency agreements, they could not do so. Mr. Furst disagreed and filed a motion seeking a judicial ruling on the issue, which

ML Manager contested through two rounds of briefing. Finally, at the eleventh hour, ML Manager conceded the issue outside the courtroom and acquiesced.

Now, in another power play, ML Manager is opposing, once again, a patently reasonable Motion, which is beneficial to all concerned parties, for no justifiable reason. ML Manager has a fiduciary duty to afford the Vistoso investors with the opportunity to discuss all of their alternatives before additional distressed sales are submitted to them for approval, and ML Manager has already promised to do so. The Court should require ML Manager to keep its word.[3]

2. ML Manager Has a Fiduciary Duty to Furnish the Vistoso Investors With Investor Contact Information to Ensure a Meaningful and Fair Vote.

ML Manager also has a *fiduciary duty* to provide the Vistoso investors with a list of all of the investors, together with their contact information (particularly their e-mail addresses and telephone numbers), so that they can openly communicate with their co-owners about the proposed transactions and/or other proposed courses of action.

As the Court will recall, Mr. Furst raised this precise issue at a prior hearing several months ago in relation to the proposed sale of the VCB property. At that hearing, Mr. Furst stated that distressed sales were being approved in flawed elections at the Loan LLC level, where only a small minority of investors were actually voting. Mr. Furst told the Court that the election outcomes would have been far different if a greater investor turnout had been

[3] ML Manager argues that the Exit Financing obligation is still an issue. However, none of the proposals contained herein adversely impact ML Manager's ability to collect Exit Financing costs because each proposal is predicated on the Non-Transferring Investors' immediate payment of their allocable share of such costs out of their own pockets. Thus, the proposals contained herein will accelerate, not postpone, the repayment of the Exit Financing.

encouraged but that ML Manager has intentionally limited investor voting by not furnishing the investors' contact information. The Court then asked Mr. Furst if he had ever filed a motion raising this issue, clearly implying that the Court saw the injustice of ML Manager's refusal to share this investor contact information. As a result, Mr. Furst has filed the instant Motion in response to the Court's invitation to him to do so.

Most Vistoso investors have lost their life's savings in this bankruptcy proceeding, and they deserve fair elections designed to reflect the will of the majority, not controlled elections manipulated by a few. Before they vote to approve or disapprove a proposed sale at a distressed price, they need to hear from Conley Wolfswinkel, the borrower in the Vistoso loans, who wants to work cooperatively with them to maximize their investment returns (unlike most of the other borrowers disappeared from sight). They need to hear about the attributes of these specific properties and the "vision" of the original borrower, who understands these specific properties even better than ML Manager. They need to hear about reasonable economic projections from disinterested experts, not just ML Manager's representations about what the properties are worth today. ML Manager argues that the Confirmed Plan does not impose any such duties on ML Manager for full disclosure and meaningful debate. Mr. Furst strongly disagrees, and he trusts that the Court will concur.

3. <u>The Vistoso Investors Have the Right to Purchase Parcels by Matching the Highest Bid from Prospective Purchasers</u>.

The Non-Transferring Investors are extremely confident that, in a fair election, the Loan LLCs for the Vistoso loans will overwhelmingly vote to continue to hold their "crown jewel" properties in order to maximize their investment return. However, if any Loan LLC

decides, for whatever reason, that it does not want to continue to hold its fractional interest, the Non-Transferring Investors want to acquire their proportionate share of the real property, and they are willing to pay their allocated share of the Exit Financing *out of their own pockets*, as ML Manager requires, in order to do so.

In its Response, ML Manager states that, if investors want to purchase either of the Vistoso properties, they can make an offer. In this regard, the Non-Transferring Investors do, in fact, intend to submit offers, but they need the Court's assistance to ensure the following:

First, the Non-Transferring Investors should be entitled to a credit for their existing ownership interest in the Vistoso properties. For example, if the purchasing investors own 60% of a Vistoso property, and they are purchasing a parcel representing 70% of the aggregate value of the two parcels, then the purchasing investors should be required to pay into escrow only the 10% differential in cash, plus their share of the Exit Financing costs. ML Manager initially opposed this provision. However, after Mr. Furst met with Cathy Reece and Mark Winkleman, and ML Manager withdrew its objection and now concurs.

Second, the Non-Transferring Investors should not be required to pay a 6% broker's commission to essentially purchase a parcel from itself. ML Manager should act in good faith and sign a listing agreement which specifically excludes from the listing any sale of one parcel to the Non-Transferring Investors. ML Manager has not committed, one way or the other, on this provision, and the Court must resolve the issue.

Third, the Non-Transferring Investors should have the right to match the best offer received by ML Manager. ML Manager opposes this proposal. ML Manager believes that the Non-Transferring Investors should be required to submit blind purchase offers, just like

the other prospective purchasers. However, such a restriction is unfair to the Non-Transferring Investors because they are co-owners of the Vistoso properties, not strangers, and they are entitled to know about the competing offers received for their own properties before they bid. The Non-Transferring Investors should be permitted to match the highest bid after ML Manager is ready to accept an offer. The Court needs to resolve this issue.

4. ML Manager Has a Fiduciary Duty to Seek a Partition for the Non-Transferring Investors.

The Non-Transferring Investors, as co-owners, have partition rights under Arizona law, and there is nothing in the Confirmed Plan, the Agency Agreements or any other supporting document that stripped them of this inherent property right. Judicial partitions are a well-recognized property right, which the investors would have exercised for themselves but for the Agency Agreements. Moreover, if anyone other than ML Manager was serving as their agent, a judicial partition would have certainly been sought. There is no valid reason for opposing a partition in the cases at hand, where there are separate, noncontiguous parcels which are easily divisible.[4]

Conclusion

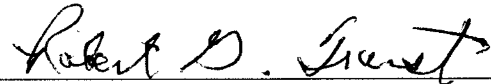
In conclusion, the undersigned requests that the Court declare that, under the Plan of Reorganization, ML Manager has the specified fiduciary duties, and the Non-Transferring Investors possess the acquisition rights, which are described herein. The Non-Transferring Investors are confident that, if they are allowed to communicate and negotiate with the

[4] ML Manager asserts that the Vistoso loans cannot be partitioned, but Mr. Furst is not arguing that point. Mr. Furst is simply asserting that, once the foreclosure sales occur and title to the property is acquired, the partitions should occur at that time.

members of the Loan LLCs, a consensual agreement can be reached that is beneficial to everyone. ML Manager desperately wants to prevent such open communication, and that is the primary issue for the Court to resolve.

Mr. Furst does not seek "individual control," as ML Manager alleges, and he is not attempting to modify the Confirmed Plan. To the contrary, ML Manager is attacking the Confirmed Plan by denying the investors the opportunity to meaningfully control their destiny, which is what they fought for and attained during the confirmation process.

DATED: April 12, 2012



Robert G. Furst