UNITED STATES DISTRICT COURT

DISTRICT OF ARIZONA

In re: MORTGAGES LTD., Debtor, REV OP GROUP and STERNBERG ENTERPRISES PROFIT SHARING PLAN, Appellants, v. ML MANAGER LLC, Appellee.	2:09-cv-2698-RCJ **ORDER**

Currently before the Court is a bankruptcy appeal (#11) arising out of a Chapter 11 bankruptcy proceeding for Mortgages Limited, Case No. 2:08-bk-7465-RJH. This particular appeal relates to the exit financing provisions in the confirmation plan.

BACKGROUND

I. General Facts[1]

This case, along with a number of others pending before this Court, arises out of the Chapter 11 bankruptcy proceedings for Mortgages Limited, case number BK NO. 08-07465. The Court notes by way of background that Mortgages Limited ("Mortgages Ltd.") once held a $900 million portfolio of loans and had over 1800 investors. Investors in Mortgages Ltd. owned fractional interests in promissory notes and deeds of trust. Investors entered

[1] These facts are taken from Judge Murguia's order, dated January 31, 2011. *See Rev Op Group v. ML Manager, LLC*, 2011 WL 334292 (D. Ariz. 2011).

agreements with Mortgages Ltd. prior to making these investments. Because investors had fractional interests in the various mortgages, when borrowers defaulted and the properties were foreclosed upon, investors became part owners of properties as tenants in common with other investors who had interests in the same loan.

On June 28, 2008, Mortgages Ltd. filed for Chapter 11 bankruptcy. The company was thus reorganized pursuant to a plan that was confirmed by the bankruptcy court. As part of the plan, an entity called ML Manager, LLC ("ML Manager"), the appellee in this case, was created to manage and operate the loans in the portfolio. The original investors for the most part transferred their interests to 49 separate Loan LLC's. A number of investors, referred to as "pass through investors" did not transfer their interests. As part of the Plan, ML Manager took out $20 million in exit financing (the "Exit Financing") to help keep the company afloat during the reorganization.

After confirmation of the plan, a dispute arose regarding the agency authority of ML Manager to take action on behalf of "pass through investors." A group of "pass through investors" referred to as the Rev Op Group, the appellants in this case, took the position that ML Manager could not sell property in which Rev Op Group members had an interest without the Rev Op Group's approval and consent. ML Manager asserted that it had the agency power to sell property in which Rev Op investors had an interest without their consent. This conflict has lead to a number of disputes within the bankruptcy court as well as a number of appeals of bankruptcy court orders currently pending before this Court.

II. The Plan & Disclosure Statement

On May 20, 2009, the bankruptcy court issued an Order Confirming Investors Committee's First Amended Plan of Reorganization dated March 12, 2009 ("the Plan"). (Confirmation Order (#16-6) at 28). The Plan stated the following with respect to the provisions at issue in this appeal. "Exit Financing" meant "the financing provided by a third

party lender on the terms as set forth on Exhibit O[2] to the Disclosure Statement which [would] be used to consummate the Plan on the Effective Date pursuant to the terms of the Plan, or financing on more favorable terms with a substitute lender." (Plan (#16-1) at 8 (¶2.35)). "Investors" meant "all Persons holding fractional or participating interests in the ML Loans or in the MP Funds which hold fractional or participating interests in the ML Loans, whether as a pass-through investor or an investor under the MP Funds, excluding the Debtor." (*Id.* at 9 (¶2.40)). "Pass-Through Investors" meant "the non-MP Funds Investors, other than the Debtor, that hold a direct fractional or participating interest in the ML Loans whether through Revolving Opportunity Loan Programs, Capital Opportunity Loan programs, Annual Opportunity Loan Programs, Opportunity Plus Loan Programs, Performance Plus Loan Programs, or other similar programs established by the Debtor." (*Id.* at 13 (¶2.62)).

Paragraph 4.13, as modified by the confirmation order's Paragraph U.3, states the following:

> **4.13 Distributions from Loan LLCs.** Each Loan LLC will distribute funds to its members pro rata based upon their respective membership percentages in such Loan LLC as set forth in the operating agreement for each of the Loan LLCs. Before such distributions are made, Pass-Through Investors who retain their fractional interests in ML Loans shall be assessed their proportionate share of costs and expenses serving and collecting the ML Loans in a fair, equitable and nondiscriminatory manner and shall be reimbursed in the same manner as the other Investors. When the MP Funds receive any distribution from the Loan LLCs, they will distribute such funds to their respective investors, after payment of any MP Fund creditors.

(Plan (#16-1) at 35; Confirmation Order (#16-6) at 39).

III. Motion for Clarification

On September 14, 2009, the Rev Op Group filed an emergency motion to clarify the confirmation order. (Mot. for Clarification (#16-6) at 45). The Rev Op Group asked the bankruptcy court, *inter alia*, to "clarify that the ML Manager LLC [did] not have the right to impose any of the expenses or other terms/provisions of the Exit Financing on the Rev Op

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[2] Exhibit O is located at Doc. #1531-22 on CM/ECF for the U.S. Bankruptcy Court for the District of Arizona, case no. 2:08-bk-7465-RJH. This order will cite to the bankruptcy court's docket as "CM/ECF #__."

Group" and did "not have the right to impose the ten percent (10%) disposition incentive payment or loan repayment provisions set forth in the Exit Financing on the Rev Op Group." (*Id.* at 51).

On October 21, 2009, the bankruptcy court granted the motion for clarification "to the extent any clarification [was] needed" and found the following:

> Paragraph U of the confirmation order permits the ML Manager to charge back to the non-opt-in participating investors their proportionate share of all of its expenses, including but not limited to the exit financing. This Plan does impose a limitation that such charge back be fair, equitable and proportional, but within those limitations the ML Manager can exercise his business judgment whether to obtain financing to cover exit costs and operational expenses, and when to make the charge backs.

(Mem. Decision (#14-10) at 1-2). On October 29, 2009, the bankruptcy court entered an order on the motion to clarify. (Order (CM/ECF #2345)). On November 13, 2009, the Rev Op Group filed a timely notice of appeal. (Notice of Appeal (CM/ECF #2401)). The Rev Op Group did not obtain a stay on any of the bankruptcy court's rulings pending appeal.

In this appeal, the Rev Op Group raises three issues: (1) whether the bankruptcy court erred in ruling that the Rev Op Investors could be charged for exit financing under the Plan; (2) whether the bankruptcy court erred in ruling that the Plan authorizes ML Manager to make decisions based on its own business judgment; and (3) whether the bankruptcy court erred by failing to change the word "serving" to "servicing" in Paragraph U.3 of the Confirmed Order. (Opening Brief (#11) at 4-5).

STANDARD OF REVIEW

The parties dispute the standard of review in this case. ML Manager argues that the standard of review is abuse of discretion, while the Rev Op Group argues that the standard of review is *de novo*. (*See* Response Brief (#21) at 13); Reply Brief (#22) at 6).

The issue before the Court is what standard of review applies when reviewing a bankruptcy court's interpretation of its own order confirming a reorganization plan. Generally, the Ninth Circuit has held that a "reorganization plan resembles a consent decree and therefore, should be construed basically as a contract." *Hillis Motors, Inc. v. Hawaii Auto. Dealers' Ass'n*, 997 F.2d 581, 588 (9th Cir. 1993). However, as the Third Circuit has noted,

"[t]here is a difference between reviewing the straightforward application of contract principles, and reviewing a bankruptcy court's interpretation of its own order contained in a confirmed plan of reorganization." *In re Shenango Group Inc.*, 501 F.3d 338, 345 (3d Cir. 2007). The Ninth Circuit has not adopted a standard for reviewing a bankruptcy court's interpretation of its own order.

This Court follows the majority of the circuits that have weighed in on this issue and finds that this Court reviews a bankruptcy court's interpretation of its own order for an abuse of discretion. *See Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 129 S.Ct. 2195, 2204 n.4, 174 L.Ed.2d 99 (2009) (noting that the First, Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth, and Eleventh Circuits have held that a "bankruptcy court's interpretation of its own confirmation order is entitled to substantial deference").

DISCUSSION

The Rev Op Group argues that the bankruptcy court erred in ruling that it could be charged for the Exit Financing. (Opening Brief (#11) at 13). The Rev Op Group argues that there is no basis in Paragraph U, or anywhere else in the Plan, that requires it to repay the Exit Financing. (*Id.* at 14-15). The Rev Op Group also asserts that the bankruptcy court erred when it diminished ML Manager's fiduciary duties by ruling that ML Manager could exercise its business judgment rather than the best interests of the investors whose assets it manages. (*Id.* at 18). The Rev Op Group argues that the bankruptcy court erred in refusing to replace the word "serving" in Paragraph U with the word "servicing." (*Id.* at 19).

In response, ML Manager argues that neither the Plan nor the confirmation order exempt the Rev Op Group from paying its fair share of the Exit Financing. (Response Brief (#21) at 14). ML Manager argues that the bankruptcy court correctly stated ML Manager's duty and that the Rev Op Group never explains why the business judgment standard is inadequate or lower than the standard that the Rev Op Group thinks should be imposed. (*Id.* at 17-18). ML Manager argues that there was no error in the language of the Plan or confirmation order and that "serving" is the correct word. (*Id.* at 19-20).

The Rev Op Group filed a reply brief. (Reply Brief (#22)).

First, the bankruptcy court did not abuse its discretion in finding that Paragraph U of the confirmation order permitted ML Manager to charge back to the non-opt in participating investors their proportionate share of all of its expenses, including the Exit Financing. Paragraph 4.13 of the Plan, as modified by the confirmation order, makes clear that Pass-Through Investors, including the Rev Op Group, "shall be assessed their proportionate share of costs and expenses serving and collecting the ML Loans in a fair, equitable, and nondiscriminatory manner." Because the Exit Financing is a cost and expense of serving and collecting the ML Loans, the bankruptcy court did not abuse its discretion by finding that the Rev Op Group must pay its fair share of the Exit Financing.

Second, the bankruptcy court did not abuse its discretion by stating that ML Manager could exercise its business judgment in determining whether to obtain financing to cover exit costs and operational expenses and when to make charge backs. The Rev Op Group's basic argument is that the business judgment rule changes ML Manager's obligation to charge the Rev Op Group its proportionate share of costs and expenses in a fair, equitable, and nondiscriminatory manner. (*See* Opening Brief (#11) at 17). This is not the case. The clarification order still directs ML Manager to impose a charge back that is fair, equitable, and proportional. Moreover, the Plan still requires ML Manager to assess a proportionate share of the costs and expenses in a nondiscriminatory manner, thus, protecting the Rev Op Group's interest. As such, the bankruptcy court did not abuse its discretion by interpreting the confirmation order to include ML Manager's use of business judgment to assess a proportionate share of the costs and expenses.

Finally, the Rev Op Group has not demonstrated that the bankruptcy court's use of the word "serving" instead of "servicing" was in error. As such, the Court AFFIRMS the bankruptcy court's clarification order.

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CONCLUSION

For the foregoing reasons, IT IS ORDERED that the bankruptcy court is AFFIRMED.

DATED: This 31st day of January, 2012.

United States District Judge