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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 SOJAC AND VISTOSO LOANS** **Hearing Date: January 25, 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 SOJAC and Vistoso Loans.

Now that the interest-bearing portion of the Exit Financing has been paid in full, the vast majority of ML investors want to hold the two Vistoso properties and the SOJAC property, which are the undisputed "crown jewels" of their real estate portfolio, until the real estate market recovers. Until now, ML Manager has repeatedly reassured the ML investors

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that, once the interest-bearing portion of the Exit Financing was repaid, the investors in each loan would be given the opportunity to determine whether they were willing to pay their allocated share of the costs of the bankruptcy *out of their own pockets* (rather than from the proceeds of additional distressed sales), so that they could continue to own some or all of their remaining loan properties until it is a more opportune time to sell.

Unfortunately, however, ML Manager is now reneging on its prior written commitment to the ML investors. ML Manager now claims that, despite its written statements to the contrary, it has no *fiduciary duty* whatsoever to schedule even any investor meeting, so that the ML investors can freely and open discuss all of their options and hear alternative viewpoints as to how they can maximize their investment return. In addition, ML Manager now claims that it has no *fiduciary duty* whatsoever to provide contact information for the ML investors, so that the investors can communicate amongst themselves and make a meaningful decision before they vote to approve or disapprove further distressed sales. In short, ML Manager believes that only ML Manager has the right to communicate with ML investors before they vote on future distressed sales, and that ML Manager, in its "sole" discretion, has the unfettered right to create artificial barriers preventing ML investors from communicating with each other, particularly if the ML investors disagree with ML Manager. 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.

ML Manager obviously recognizes that the ML investors will approve a proposed distressed sale of the two Vistoso properties or the SOJAC property ***only if*** ML Manager can

limit the voter turnout by whatever means possible. If only 10% of the ML investors actually vote, ML Manager believes that additional distressed sales can be approved. However, if 70% or more of the investors should vote (after given the opportunity to meaningfully evaluate their alternatives), ML Manager knows that future proposed distressed sales will be overwhelmingly disapproved, which would be embarrassing for ML Manager and eye-opening to the investor community.

It is for that reason --- to ensure a fair and honest vote --- that the Motion should be granted. ML investors do not deserve to be victimized once again.

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

> 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, in its Response, dismissively claims that the outcome for the GP Property investors "was a solution for that loan only" and suggests that ML Manager voluntarily agreed to that limited solution. However, that is simply not true. ML Manager vigorously opposed the "solution" when it was initially proposed by Mr. Furst. ML Manager

initially argued that, even if 100% of the investors 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 establishing the investors' rights, which ML Manager contested through two rounds of briefing. Finally, at the eleventh hour, ML Manager conceded the issue outside the courtroom and acquiesced to a "solution" for GP Property that should have been achievable without any contest. Now, in another obvious power play, ML Manager is opposing another noncontroversial, patently reasonable Motion submitted by Mr. Furst, which is beneficial to all concerned parties, for no justifiable reason.

ML Manager has a fiduciary duty to afford the ML 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. Mr. Furst simply asks the Court to require ML Manager to keep its word. Any future elections, without procedural "due process" guarantees, would be inherently flawed and illegitimate.

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

Before any additional elections are held to approve or disapprove proposed distressed sales, ML Manager also has a *fiduciary duty* to provide the ML 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 approximately three 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 the ML investors were actually voting. Mr. Furst told the Court that the election outcomes would have been far different if a greater investor turnout was encouraged but that ML Manager has intentionally limited investor voting by not furnishing the investors' contact information to other requesting investors. 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 filed the instant Motion pertaining to the Vistoso and SOJAC loans (and the investors' inherent rights to communicate with each other before voting) in response to the Court's invitation to him to do so.

Most ML 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 and Dale Jensen, the borrowers in the Vistoso and SOJAC loans, who want 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 borrowers, who understand 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 trusts that the Court will concur.

3. ML Manager Has a Fiduciary Duty to Submit Proposed Sales Offers from Non-Transferring Investors to the Loan LLCs For Their Approval Vote.

The Non-Transferring Investors are extremely confident that, in a fair election, the Loan LLCs for the Vistoso and SOJAC 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 "[i]f investors want to purchase either of the Vistoso properties, they can contact the broker and make a cash offer like any other buyer." In this regard, the Non-Transferring Investors do, in fact, intend to submit offers on each property, but ML Manager's statement of position creates a series of **artificial barriers** for the Non-Transferring Investors which are unfair, unnecessary and discriminatory.

First, the Non-Transferring Investors should not be required to submit an all-cash offer because they are entitled to a credit for the value of their fractional ownership interest in each property which they are relinquishing. For example, the first Vistoso loan (Loan # 847406) consists of two parcels, one which is zoned for an apartment building and the other which is zoned for a commercial midrise office building. Assume that ML Manager concludes that the two parcels are worth $2,000,000 and wants to sell the first parcel for $1,200,000 (i.e., 60% of the total value) and the second parcel for $800,000 (i.e., 40% of the total value). If the Non-Transferring Investors want to acquire the second parcel, the Non-

Transferring Investors are entitled to a credit for the value of their fractional ownership interest in the two parcels which they are relinquishing. In other words, if the Non-Transferring Investors hold a 30% fractional ownership interest in the two parcels, they should get a $600,000 purchase price credit (i.e., 30% x $2,000,000), and they should only be required to deposit $200,000 cash into escrow. However, if the Non-Transferring Investors hold a 40% ownership interest in the two parcels, they should get an $800,000 purchase price credit (i.e., 40% x $2,000,000), and they should not be required to deposit any cash into escrow.

ML Manager's requirement that the Non-Transferring Investors must deposit $800,000 cash into escrow and then wait for months until the $800,000 is returned to them as their share of the total sales proceeds from the two sales is punitive, unfair and unnecessary. If a third-party creditor had an $800,000 lien on the two parcels and wanted to acquire the second parcel valued at $800,000, the creditor would be entitled to an $800,000 credit in escrow in accordance with customary business practices and would not be required to deposit any cash into escrow. ML Manager wants to treat the Non-Transferring Investors differently. The Court should not allow ML Manager to "freeze" the Non-Transferring Investors out of the bidding process by the imposition of unnecessary and punitive conditions.

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 (or, alternatively, it should be required by the Court to 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. This is just common decency to a property co-owner, and nothing more.

Third, the Non-Transferring Investors should not be required to buy all parcels secured by the same loan. As stated above, one of the Vistoso properties consists of two parcels, one which is zoned for an apartment building and the other which is zoned for a commercial midrise office building. Different developers will be interested in each parcel, and the Non-Transferring Investors should be permitted to buy one of the parcels, just like any other prospective purchaser could do. Importantly, separate sales of the two parcels should lead to a greater return for all investors, and to the disadvantage of no one.

In sum, the Non-Transferring Investors need to be ensured of at least equal footing with other prospective investors. ML Manager believes that the Confirmed Plan permits ML Manager to do anything it wants, in its "sole" discretion, without regard to fairness. Unfortunately, the Court must remind ML Manager of its fiduciary role, supervise its bid selection process and protect the investors from ML Manager's anticipated hostile tactics.

4. If Any Loan LLC Does Not Approve a Sale to the Non-Transferring Investors at Full Price, ML Manager Has a Fiduciary Duty to Seek a Partition for the Non-Transferring Investors.

In the unlikely event that any Loan LLC elects to not accept an offer from the Non-Transferring Investors and wants to accept an equivalent offer from a third-party purchaser, ML Manager has a fiduciary duty to step in and protect the interests of the Non-Transferring Investors. The Loan LLC can only decide to sell the fractional interest owned by the Loan LLC; ML Manager makes the final decision to sell the fractional interest owned by the Non-Transferring Investors. If the Loan LLC attempts to unreasonably discriminate against the

Non-Transferring Investors' offer in favor of an equivalent offer from a third-party purchaser (which the undersigned does not believe will ever happen), ML Manager has a fiduciary duty to protect its principal and exercise the partition rights held by 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 this inherent property right from any ML investor.

There is no need to belabor this point at this time, because it is extremely remote that the investors in any Loan LLC, who are generally close friends of the Non-Transferring Investors with no ill will toward any of them, would try to prevent the Non-Transferring Investors from continuing their investment in any of the properties. For some unexplained reason, only ML Manager wants to inflict further damage (or prevent future economic rewards) to the Non-Transferring Investors.

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 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 sole issue for the Court to resolve.

DATED: January 23, 2012

Robert G. Furst