

**UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA**

IN RE MORTGAGES LTD.,)	JUDGMENT IN A CIVIL CASE
Debtor.)	
_____)	CV 11-1557-PHX-RCJ
REV OP GROUP,)	
Appellants,)	
)	
v.)	
)	
ML MANAGER LLC,)	
Appellee.)	
_____)	

 Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

 X Decision by Court. This action came for consideration before the Court. The issues have been considered and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that pursuant to the Court's Order filed July 6, 2012 the Bankruptcy Appeal is REVERSED and REMANDED for further proceedings. This action is hereby terminated.

BRIAN D. KARTH
District Court Executive/Clerk

July 6, 2012

s/L. Figueroa
By: Deputy Clerk

cc: (all counsel)

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**UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA**

IN RE MORTGAGES LTD.,
Debtor.

REV OP GROUP,
Appellants,
v.
ML MANAGER LLC,
Appellee.

2:11-cv-1557-RCJ

ORDER

17 Currently before the Court are a bankruptcy appeal (#9) and a motion for judicial notice
18 of prior proceedings (#14). The Court heard oral argument on May 3, 2012.

FACTS

I. Background¹

21 These cases arise out of the Chapter 11 bankruptcy proceedings for Mortgages Limited,
22 case number BK No. 08-07465. Based on the pleadings and information that have been
23 submitted to the Court, the Court notes by way of background that Mortgages Limited
24 ("Mortgages Ltd.") once held a \$900 million portfolio of loans and had over 1800 investors.

25 Investors in Mortgages Ltd. owned fractional interests in promissory notes and deeds
26 of trust. Investors entered agreements with Mortgages Ltd. prior to making these investments.

27 _____
28 ¹ ML Manager filed a motion for judicial notice of prior proceedings. (Mot. for Judicial
Notice (#14) at 1). In that motion, ML Manager moves for this Court to take judicial notice of
its prior orders affirming the bankruptcy court's decisions in this case. (*Id.* at 2). The Court
grants this motion (#14).

1 Because investors had fractional interests in the various mortgages, when borrowers defaulted
2 and the properties were foreclosed upon, investors became part owners of properties as
3 tenants in common with other investors who had interests in the same loan.

4 On June 28, 2008, Mortgages Ltd. filed for Chapter 11 bankruptcy. The company was
5 thus reorganized pursuant to a plan that was confirmed by the bankruptcy court on March 20,
6 2009 (“the Plan”). As part of the Plan, an entity called ML Manager, LLC (“ML Manager”) was
7 created to manage and operate the loans in the portfolio. The original investors for the most
8 part transferred their interests to 49 separate Loan LLCs. A number of investors, referred to
9 as “pass through investors” did not transfer their interests. As part of the Plan, ML Manager
10 took out \$20 million in “exit financing” (the “Exit Financing”) to help keep the company afloat
11 during the reorganization.

12 After confirmation of the Plan, a dispute arose regarding the agency authority of ML
13 Manager to take action on behalf of “pass through investors.” A group of 17 “pass through
14 investors,” referred to as the Rev Op Group, took the position that ML Manager could not sell
15 property in which its members had an interest without their approval and consent. ML
16 Manager asserted that it had the agency power to sell property in which Rev Op investors had
17 an interest without their consent. Because of the dispute, ML Manager initiated a declaratory
18 action in the bankruptcy court, seeking a ruling on its ability to act as an agent for the Rev Op
19 Group and filed a motion for Judgment on the Pleadings. The bankruptcy court ultimately
20 issued a Declaratory Judgment, finding that investors in the Rev Op Group had signed
21 agreements with Mortgages Limited that incorporated an Agency Agreement, which created
22 an irrevocable agency for Mortgages Ltd. to manage the loans. The bankruptcy court also
23 ruled that the agency had been effectively and properly assigned to ML Manager and that ML
24 Manager did not need the consent of Rev Op Group investors to liquidate assets in which they
25 held an interest.

26 ML Manager has begun to sell properties that were part of the Mortgages Ltd. portfolio.
27 ML Manager is selling these assets in an effort to obtain returns for investors, but also to make
28 payments on the \$20 million Exit Financing it obtained.

1 **II. Allocation Model**

2 After confirmation of the Plan, ML Manager submitted a motion to approve an allocation
3 model that had general applicability to all investors (“Allocation Model”). (See Allocation Model
4 (#10-6) at 1). In the motion, ML Manager explained that the Allocation Model would use the
5 business judgment test and explained its authority for using that test and why the test had
6 been satisfied. (*Id.* at 5-9). The motion also explained the reasons and textual support for the
7 Allocation Model. (*Id.* at 15-17). The motion also provided a detailed description of the
8 allocation steps, including: (1) determine outstanding loan balances, (2) loan recovery
9 analysis, (3) recalculate the sharing ratio, (4) estimate the disposition period, (5) estimate the
10 expected costs, (6) separate expected costs into general and specific costs, (7) spread the
11 separated costs, (8) determine withholding from distributions, (9) repayment of replacement
12 loans and permitted reserves prior to final settlement, and (10) final settlement and true up.
13 (*Id.* at 20-26).

14 After listening to oral argument on the motion for the approval of the Allocation Model,
15 the bankruptcy court issued a minute order “approving the allocation formula proposed by ML
16 Manager.” (See CM/ECF case no. 2:08-bk-7465-RCJ, Minute Entry (#2959) at 2). The Rev
17 Op Group appealed the order approving the Allocation Model and this Court affirmed the
18 bankruptcy court’s order. (See CM/ECF case no. 2:11-cv-200-RCJ, Order (#40) at 3-5).

19 **III. First Distribution Motion**

20 On December 17, 2010, ML Manager filed a notice of intent to distribute proceeds
21 associated with six of the loans associated with the Plan in accordance with the Allocation
22 Model and a motion to approve the treatment of distribution of disputed proceeds (“First
23 Distribution Motion”). (First Distribution Mot. (#10-10) at 1). The Rev Op Group filed
24 objections to the First Distribution Motion. (Objection to First Distribution Mot. (#11-1) at 1).
25 The Rev Op Group argued that ML Manager had a fiduciary duty to investors and could not
26 invoke the business judgment standard for distributions. (*Id.* at 3). The Rev Op Group argued
27 that pre-confirmation professional fees had to be allocated to the Liquidating Trust or to
28 specific loans or investors and argued that the Allocation Model did not comply with the Plan.

1 (*Id.* at 3-4). The Rev Op Group asserted that expenses related to the Centerpoint Project, or
2 Stratera DIP, had to be assessed against the Centerpoint Project Investors or the Liquidating
3 Trust. (*Id.* at 4). The Rev Op Group also argued that the asserted set off claim was
4 unfounded based on disputed provisions of the agency agreement. (*Id.* at 5). ML Manager
5 filed a reply. (See Reply to First Distribution Mot. (#11-2)).

6 After holding oral argument on the motion, the bankruptcy court issued an order on the
7 distribution of the proceeds (“First Distribution Order”). (First Distribution Order (#11-4) at 1).
8 The bankruptcy court found that the First Distribution Motion was related to or based on the
9 implementation of the Allocation Model and that ML Manager had liquidated six of the loans,
10 collateral, or properties in the Plan. (*Id.*). The bankruptcy court granted the First Distribution
11 Motion and found that ML Manager was authorized to make the distributions contemplated in
12 the motion except as otherwise stated in the motion. (*Id.* at 2). The bankruptcy court found
13 the following. (*Id.*). First, the Allocation Model provided that “all Investors in the ML Loans
14 where there [was] a distribution [had to] pay their proportionate share of the ‘General Costs’
15 including pre-confirmation expenses, and post confirmation general expenses, as well as
16 ‘Loan Specific Costs’ incurred after the confirmation” of the Plan. (*Id.* at 2-3). The appropriate
17 standard of review for ML Manager’s allocation decisions was the business judgment
18 standard. (*Id.* at 3). ML Manager’s treatment of the Allocation Model regarding the obligations
19 incurred by the debtor, the administrative expenses, and other pre-confirmation costs and
20 expenses as General Costs was approved, appropriate, and consistent with ML Manager’s
21 business judgment and was consistent with and in fulfillment of its fiduciary duties. (*Id.*). “All
22 of the objections to the distribution of proceeds under the six Loans except any objections that
23 ha[d] been specifically reserved by [the court], ha[d] been overruled.” (*Id.*). With regard to
24 the six Loans at issue, “the determination, allocation and proposed distribution of costs,
25 expenses and proceeds under the Allocation Model [was] approved.” (*Id.* at 3-4). ML
26 Manager was entitled to an off-set. (*Id.* at 6-7).

27 The Rev Op Group appealed the First Distribution Order and this Court affirmed that
28 order. (Notice of Appeal (#11-5) at 1; see CM/ECF case no. 2:11-cv-200-RCJ, Order (#40)

1 at 3-5).

2 **IV. Second Distribution Motion**

3 On June 27, 2011, ML Manager filed a motion to authorize a second distribution of
4 proceeds with another six loans associated with the Plan in accordance the Allocation Model
5 and to approve treatment of disputed distribution proceeds (“Second Distribution Motion”).
6 (Second Distribution Mot. (#12-1) at 1). The motion stated that the loans had generated over
7 \$49 million in gross proceeds, payments, or recovery. (*Id.* at 2). ML Manager stated that it
8 had deducted settlement costs in the amount of \$21 million and had paid the exit lender \$10
9 million. (*Id.*). ML Manager stated that after expenses and payments to the exit lender there
10 were \$9 million left in net proceeds. (*Id.*). ML Manager, where applicable, would take out the
11 “Permitted Reserve” to pay costs and operations. (*Id.*). The motion stated that, pursuant to
12 the Allocation Model approved by the court, the “Total Estimated Costs” that were not included
13 in the payments to the exit lender would be deducted and the balance would be distributed to
14 investors. (*Id.*). ML Manager sought authorization for the second distribution of net proceeds
15 from the loans at issue pursuant to the Allocation Model approved by the court. (*Id.* at 6).

16 The Rev Op Group filed objections to the Second Distribution Motion. (Objection to
17 Second Distribution Mot. (#12-4) at 1). In their objections, the Rev Op Group incorporated,
18 by reference, their “objections to the Allocation Model and the first distribution.” (*Id.* at 3). The
19 incorporated objections included: (1) challenging ML Manager’s ability to charge back costs
20 of the Exit Financing to the Rev Op Group; (2) alleging that the Allocation Model and
21 distribution was inconsistent with the Interborrower Agreement and Plan; (3) arguing that ML
22 Manager had fiduciary duties to the Rev Op Group and could not use the business judgment
23 standard; and (4) arguing that the Rev Op Group should not have to pay expenses associated
24 with the Centerpoint Project. (*Id.* at 3-4). The Rev Op Group also argued that the Second
25 Distribution Motion suffered from fatal deficiencies because ML Manager had not provided
26 accounting of the proposed distribution that disclosed the full amount of the gross proceeds
27 and the accounts for their distribution in specific terms. (*Id.* at 4). The Rev Op Group asserted
28 that ML Manager had to disclose specific amounts and their intended recipients and not

1 approximations and generalizations. (*Id.* at 4-5). The Rev Op Group also requested that the
2 bankruptcy court issue a discovery schedule and set an evidentiary hearing. (*Id.* at 6).

3 ML Manager filed a reply. (Reply to Second Distribution Mot. (#12-5) at 1). ML
4 Manager argued that the Rev Op Group's arguments had already been "uniformly rejected or
5 overruled" by the bankruptcy court and were without merit because the Allocation Model did
6 contain or provide for such an "accounting." (*Id.* at 4). ML Manager asserted that the
7 bankruptcy court had already considered and ruled on the adequacy of the "accounting" in
8 connection with the Allocation Model. (*Id.* at 5). With respect to additional discovery, ML
9 Manager argued that the Rev Op Group failed to identify exactly what evidence was needed.
10 (*Id.* at 7). ML Manager also argued that there was no need for an evidentiary hearing because
11 the court had already approved the Allocation Model. (*Id.* at 8).

12 On July 19, 2011, the bankruptcy court held a hearing on the motion. (Transcript (#12-
13 7) at 1). During the hearing, ML Manager argued that the Rev Op Group's accounting
14 objection was inappropriate because that issue had been litigated during the Allocation Model
15 motions and hearings at some length. (*Id.* at 17). ML Manager argued that the Rev Op Group
16 had failed to identify a specific issue or reason as to why there needed to be an evidentiary
17 hearing. (*Id.* at 22). ML Manager asserted that there had been no evidentiary hearing on the
18 First Distribution Motion. (*Id.*).

19 At the hearing, the bankruptcy court asked ML Manager to address the Rev Op Group's
20 argument that ML Manager had changed the Allocation Model in the last several months. (*Id.*
21 at 23). ML Manager responded that the Allocation Model had projections of what the sales
22 prices would be and that when they had actual sales, they had changed the projection to an
23 actual sale number. (*Id.*). ML Manager explained that the only change to the Allocation Model
24 was that they had exchanged projections for actual costs and expenses and had updated the
25 numbers. (*Id.* at 23-24).

26 At the hearing, the Rev Op Group argued that they had made objections based on the
27 information they had, which was not very much. (*Id.* at 28). The Rev Op Group argued that
28 they had not understood ML Manager's math in the Second Distribution Motion. (*Id.* at 28-29).

1 The bankruptcy court asked why those arguments were not “in effect” re-arguing their
2 objections to the Allocation Model. (*Id.* at 30). In response, the Rev Op Group asserted that
3 the court had approved the Allocation Model in principle and then had stated that when there
4 were specifics before the court, it would consider them. (*Id.*). The Rev Op Group argued that
5 it did not have the specifics and, therefore, needed discovery and an evidentiary hearing. (*Id.*
6 at 31-32). The court stated, “It sounds like you’re asking for an evidentiary hearing though
7 without being able to identify what fact dispute that’s material that [the court] would need to
8 decide.” (*Id.* at 32).

9 At the hearing, the bankruptcy court also asked what was its authority to make any
10 ruling to authorize a distribution and what standards should govern that decision. (*Id.* at 36).
11 The court asked whether the Plan had stated that it had to approve any distribution before one
12 was made. (*Id.* at 37). The Rev Op Group acknowledged that ML Manager could make the
13 distribution without any authorization from the court. (*Id.* at 37-38). ML Manager responded
14 that when the court had approved the Allocation Model, including accounting, ML Manager had
15 asked whether it could just distribute the money by applying the Allocation Model going
16 forward. (*Id.* at 39). The court had responded “no” and stated that it had wanted ML Manager
17 to come back to the court before distributing any money. (*Id.*). ML Manager stated that,
18 although the Plan did not require the court to approve the distribution, ML Manager had come
19 back upon request from the court. (*Id.*).

20 At the hearing, the bankruptcy court stated:

21 Based upon what I’ve now heard from both counsel as to my authority over this
22 motion, it’s ordered granting the motion solely on the basis though that it
23 satisfies any prior requirement I may have made that a distribution be brought
24 back before me, whether in the context of approving the allegation
25 model—allocation model or in the context of approving the particular sale and/or
26 settlement, I find that this motion satisfies that requirement and that will be the
27 extent of my order. And I think so that we don’t have any further dispute over
28 what I approved or not approved, I’ll simply sign the minute entry and that will be
the order on this motion.

26 (*Id.* at 42). Upon clarification, the court stated that it was “granting the motion by finding that
27 it satisfies any prior requirement [that it] may have made that this matter be brought before [it].”
28 (*Id.* at 43).

1 On July 19, 2011, the bankruptcy court issued a minute order granting the Second
2 Distribution Motion “solely on the basis that it satisfie[d] any prior requirement the Court may
3 have made that a distribution be brought back before the Court whether in the context of
4 approving the Allocation Model or in the context of approving a particular sale and/or
5 settlement. The Court finds that this motion satisfies that requirement.” (Second Distribution
6 Order (#12-6) at 2).

7 The Rev Op Group filed a timely notice of appeal. (Notice of Appeal (#12-8)). Although
8 the Rev Op Group presents three issues² on appeal, the only issues on appeal are whether
9 the bankruptcy court erred in entering the Second Distribution Order and whether the
10 bankruptcy court abused its discretion by failing to hold an evidentiary hearing.

11 STANDARD OF REVIEW

12 This Court reviews a bankruptcy court’s interpretation of the law *de novo* and its factual
13 findings for clear error. *Blausey v. U.S. Trustee*, 552 F.3d 1124, 1132 (9th Cir. 2009). This
14 Court reviews a bankruptcy court’s decision whether to hold an evidentiary hearing for abuse
15 of discretion. *In re Int’l Fibercom, Inc.*, 503 F.3d 933, 946 (9th Cir. 2007).

16 DISCUSSION

17 The Rev Op Group challenges the validity of the Allocation Model and the bankruptcy
18 court’s order granting the second distribution under the Allocation Model. (See Opening Brief
19 (#9) at 16-17). In making that challenge, the Rev Op Group argues that they are not
20 borrowers of the Exit Financing and that the Allocation Model contravenes the Plan and the
21 Interborrower Agreement. (*Id.*). The Rev Op Group argues that the bankruptcy court erred
22 in granting the Second Distribution Motion because the court failed to address the substance
23 of the motion and its objections. (*Id.* at 17). The Rev Op Group asserts that the bankruptcy

24
25 ² The Rev Op Group presents the following issues for appeal: (1) whether the
26 bankruptcy court erred in entering the Second Distribution Order; (2) whether the bankruptcy
27 court erred in entering the Second Distribution Order despite the bankruptcy court’s own
28 recognition that it had no authority to approve any distributions under the confirmed plan of
reorganization; and (3) to the extent that the bankruptcy court had jurisdiction and authority
to enter the Second Distribution Order, whether the bankruptcy court erred in approving the
distribution in accordance with the Allocation Model without any financial detail, accounting
information, or evidence. (Opening Brief (#9) at 4).

1 court made no findings of fact or conclusions of law regarding the substantive relief requested
2 and only found that ML Manager had presented the distribution request to the court. (*Id.* at
3 18). The Rev Op Group argues that the bankruptcy court abused its discretion by failing to
4 conduct an evidentiary hearing because there were disputed issues of material fact³ and that
5 those facts were critical to granting the Second Distribution Motion. (*Id.* at 18-19). The Rev
6 Op Group also argues that ML Manager has fiduciary duties to the Rev Op Group and that the
7 Second Distribution Order is inconsistent with ML Manager's fiduciary duties. (*Id.* at 19-20).

8 In response, ML Manager argues that the Rev Op Group's arguments are foreclosed
9 by the law of the case because this Court has affirmed all of the previous orders that the
10 bankruptcy court relied on to make its ruling on the Second Distribution Motion and Order.
11 (Resp. Brief (#13) at 11-12). ML Manager also argues that the Rev Op Group's arguments
12 are foreclosed by mootness because the Rev Op Group failed to obtain a stay and ML
13 Manager has distributed funds to over 1500 investors. (*Id.* at 13-14).

14 The Rev Op Group filed a reply. (Reply Brief (#16)).

15 In this case, the bankruptcy court did err by issuing the Second Distribution Order.
16 However, the Court notes that the Rev Op Group's appeal challenges prior bankruptcy
17 decisions that this Court has already affirmed. This Court has already affirmed the bankruptcy
18 court's order finding that the Rev Op Group must pay its fair share of the Exit Financing. (See
19 CM/ECF case no. 2:09-cv-2698-RCJ, Order (#48) at 6). Additionally, this Court has already
20 affirmed the bankruptcy court's order approving the Allocation Model and the First Distribution
21 Order. (See CM/ECF case. no. 2:11-cv-200-RCJ, Order (#40) at 3-5). Therefore, to the extent
22 that the Rev Op Group argues that the bankruptcy court erred in granting the Second
23 Distribution Motion based on these previous decisions, there is no error.

24 Nevertheless, the Court reverses the Second Distribution Order and remands. The
25 Court finds that the bankruptcy court has jurisdiction to consider the Rev Op Group's

27 ³ The Rev Op Group asserts that they had identified ML Manager's failure to provide
28 any analysis, support, or evidence to support the allocation and distribution of \$9 million of the
\$49 million collected. (Opening Brief (#9) at 19).

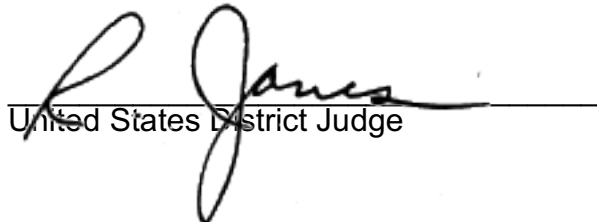
1 objections to the Second Distribution Motion. The Court finds that the bankruptcy court must
2 consider the Rev Op Group's monetary objections concerning the funds going into the
3 Allocation Model because the bankruptcy court said it would. The Court remands in order for
4 the bankruptcy court to consider these objections before deciding whether to grant or deny the
5 Second Distribution Motion. Accordingly, the Court REVERSES the Second Distribution Order
6 and REMANDS.

7 **CONCLUSION**

8 For the foregoing reasons, IT IS ORDERED that the bankruptcy appeal (#9) is
9 REVERSED and REMANDED.

10 IT IS FURTHER ORDERED that the Motion for Judicial Notice of Prior Proceedings
11 (#14) is GRANTED.

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13 DATED: This 6th day of July, 2012.

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16 United States District Judge
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