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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 **ML MANAGERS' RESPONSE TO ROBERT FURST'S MOTION FOR DECLARATION OF RIGHTS UNDER THE PLAN OF REORGANIZATION FOR THE PASS-THROUGH INVESTORS IN THE VISTOSO LOANS** Hearing Date: March 8, 2012 Hearing Time: 1:30 p.m.

ML Manager LLC ("ML Manager"), as the Manager for the Loan LLCs and the MP Funds and the Agent for the Pass-Through Investors, hereby files its response to Mr. Furst's Motion for a Declaration of Rights under the Plan of Reorganization For the Pass-Through Investors in the Vistoso Loans (the "Motion")(Docket No. 3445).[1] As explained below, there are a number of procedural and substantive reasons why the Motion should

[1] The Court may remember Mr. Furst filed a similar motion (Docket No. 3387) but withdrew it without prejudice (Docket No. 3420). ML Manager had filed a response to that motion (Docket No. 3411). The prior motion addressed the SOJAC Loan and the Vistoso Loans. ML Manager filed a Motion to Sell the SOJAC property (Docket No. 3416) Mr. Furst did not object to that Motion to Sell the SOJAC property and the Court approved the sale.

not be granted.

1. ML MANAGER HAS BEEN SUCCESSFUL AND HAS FAITHFULLY BEEN CARRYING OUT AND IMPLEMENTING THE INVESTORS PLAN BUT STILL HAS TO REPAY THE REPLACEMENT LOANS TO LOAN LLCS.

ML Manager in the exercise of its business judgment and consistent with its fiduciary duties to all investors has worked diligently to be fair to all investors, to maximize their return of money and to follow faithfully the Confirmed Plan, Confirmation Order, the Loan LLC Operating Agreements, the MP Fund Operating Agreements, the Agency Agreements, the Interborrower Agreement and the other operative documents. ML Manager has had major success in the 2½ years since confirmation in obtaining possession of the properties from the borrowers, in liquidating the properties, in paying off the principal and interest of the exit financing, paying off all but $515,000 of the exit financing's $7.5 million Disposition Incentive Payment and making two distributions to investors. ML Manager made two distributions to investors in 2011 which represents sales or collection of 15 loans/properties. ML Manager should be making its third distribution in March 2012 to investors, which represents another 10 properties which were sold.

With closing of the Portales sale February 28, 2012, ML Manager has only $515,000 left of the Disposition Incentive Payment to pay. ML Manager still needs to use 60% to 70% of the net sales proceeds from the Loan LLC portions of future sales to repay the Replacement Loans owed to the earlier Loan LLCs that let 70% of their net sale proceeds be used to pay down the exit financing. As the Court will remember the Replacement Loans owed by the Loan LLCs to the earlier Loan LLCs bear interest at the rate of 17.5% percent.

ML Manager has regularly communicated with all investors through its newsletters (it has sent over 21 newsletters), through its website where pleadings, property information and tax information is regularly posted (www.mtgltd.com) and has sent out over 45 ballots to the Loan LLC and MP Funds Investors for a vote on Major Decisions. ML Manager takes seriously its duties and responsibilities and has exercised its best business judgment at every turn for the investors but also has made sure the investors are

well informed and have current information to make intelligent decisions. When ML Manager has gone to the investors in the Loan LLCs and the MP Funds with a Major Decision it is to recommend a course of action based on its best business judgment. The Loan LLCs are manager-managed and not member-managed and were set up under the Plan so that ML Manager would make proposals to the investors, not the other way around. The Pass-Through Investors had granted sole discretion to the agent to make all decisions and under the Plan were given the opportunity to transfer into the Loan LLC so they could have a voice on Major Decisions. As the Court has noted at previous hearings, this voice was a major reason Pass-Through Investors were interested in transferring into the Loan LLCs.

However in the Motion Mr. Furst wants to impose "fiduciary duties" that do not exist and impose a "right" to partition that does not exist. While ML Manager communicates constantly with the investors and considers their suggestions, ML Manager is not required to follow the instructions of the Pass-Through Investors or to take actions that ML Manager does not recommend, support or believe are in the best interest of the investors. ML Manager requests that the Court deny Mr. Furst's Motion.

2. **THE MOTION IS FACTUALLY FLAWED AND INACCURATE**.

The factual premise of the Motion is flawed and inaccurate. First and foremost, while the interest bearing portion of the exit financing debt has been repaid, the non-interest bearing Disposition Incentive Payment has not been paid in full. There is $515,000 left of the Disposition Incentive Payment to be paid. At this point under the Loan Agreement ML Manager can only use 10% of the net sale proceeds to payoff the Disposition Incentive Payment. ML Manager still needs to repay the Replacement Loans which bear interest at the same rate. Under the Interborrower Agreement, the Replacement Loans owed to the Loan LLCs that have sold their properties and allowed 70% of their net sale proceeds to be used to pay off the exit financing are an outstanding liability of the other Loan LLCs and bear interest at the same rate as the exit financing, 17.5% per annum. As the proceeds from the future sales are obtained at closings, ML Manager will

be using a large portion of the sale proceeds from each sale to repay the Replacement Loans including the accruing interest. This is a significant obligation that has to be repaid. As a result, ML Manager believes that in exercising its business judgment it needs to continue to list the properties for sale and liquidate the properties as contemplated under the Confirmed Plan and as testified to at the Confirmation hearings.[2]

Second, the Confirmed Plan and Confirmation Order and the many documents which govern the relationships of the parties, including the Agency Agreements and the Loan LLC Operating Agreements, are complex and do not permit or contemplate partition or division of the property and do not provide for the fiduciary duties which Mr. Furst is trying to impose. As the Court has noted on many occasions, the Confirmed Plan is a liquidating plan. The Loan LLC Operating Agreements which were attached to the Disclosure Statement and approved in the Plan process and the MP Fund Operating Agreements provide that all payments and distributions to the investors in those entities shall be in cash. It was not contemplated that the Loan LLCs or the MP Funds or the Non-transferring Pass-Through Investors would divide or partition the undivided fractional interests in property among themselves. Further the Agency Agreement itself provides that as long as the investor does not own 100% of the property after foreclosure ML Manager continues to manage and sell the property for all the investors with interests in the property. All the documents contemplate and are designed so as to provide for common management and to maximize the value and return to investors.[3]

As for the Vistoso loans, contrary to Mr. Furst's allegations in the Motion, the

[2] ML Manager has no problem if investors want to purchase a property. Once ML Manager has foreclosed, they can contact the broker and make a cash offer like any other buyer. Such a purchase solves both concerns—it allows them to keep the property but it provides the way-out for the Loan LLC and their investors and pays the accruing holding costs for all and the Replacement Loan.

[3] The GP Property which is cited by Mr. Furst involved only 21 investors. No Loan LLC was created and no MP Fund investors are involved in the GP Property. No partition or division of the property took place or was requested. Instead, ML Manager with the agreement of all of the 21 investors in the loan agreed to terminate the Agency Agreement as to all 21 investors on that loan. They continued to hold their undivided fractional interests. Under the Agency Agreement, ML Manager was permitted in its sole discretion to terminate the agreement provided the investor paid the required amounts under the Agency Agreement and Allocation Model. That was a solution for that loan only.

Loan LLCs own a majority of the undivided fractional interests in each of the loans and all 9 of the MP Funds are in each of those two loans. So in addition to considering its duties to the Pass-Through Investors in the loans, ML Manager must also consider its duties to the 1500 investors in the MP Funds and Loan LLCs. ML Manager has spent a significant amount of time and professional fees in reviewing and analyzing the legal, factual and practical issues involved in partition and believes that it is not permitted by the existing documents. While it sounds simple in concept, ML Manager has determined that such actions will not be simple, are not straightforward, are costly and could impair the value of the remaining property for the other investors in the loans.[4]

As for the two Vistoso loans, contrary to the allegations of Mr. Furst, the Loan LLC in each loan owns a majority of the interests, not the other way around. VP II Loan LLC owns 71% of the undivided fractional interests in one loan and VP I Loan LLC owns 54% of the undivided fractional interests in the other loan. All 9 MP Funds are in both loans and so over 1500 investors are in each loan. These two loans are still loans evidenced by notes and deeds of trust. ML Manager has not foreclosed on the properties but is in the process of negotiating a complex settlement with the Wolfswinkle entities, including the guarantors. There are 6 loans involving the Wolfswinkle entities which owe over $100 million. The Vistoso loans are merely 2 of the 6 loans. Since confirmation of the Plan, the parties have been involved in prolonged, intensive and complex negotiations for a global resolution. An initial agreement in principal on the key terms has been reached but additional due diligence is underway in that regard. Any final settlement will require documentation and appropriate notices and approvals. At this point in time, ML Manager represents 100% of the undivided fractional interests as Agent and Manager and

[4] Contrary to Mr. Furst's allegations, ML Manager in Newsletter #10 dated June 29, 2010, did not "promise" the Pass-Through Investors that they could seek a partition. ML Manager indicated that it would examine various solutions and alternatives, as it did with the GP Properties in August 2010. It also did not agree to allow the Pass-Through Investors to have a vote on any issues. This is addressed to the Loan LLCs who already have a right to vote on Major Decisions. ML Manager has considered and continues to review and analyze what is in the best interest of all of the investors within the constraints and requirements of the Confirmed Plan, the Interborrower Agreement, the Operating Agreements and the Agency Agreements.

can maximize the return to all the investors. To partition the loan itself would be a nightmare and would interfere with the settlement and recovery for all investors. It is not even clear that the loans and causes of action can be legally split. Once the properties are foreclosed upon, ML Manager anticipates it will be able to market and sell the Vistoso properties promptly to home builders and developers and use the sale proceeds to pay the Replacement Loans which accrues interest at 17.5% per annum. If investors want to purchase either of the Vistoso properties, they can contact the broker and make a cash offer like any other buyer.

3. **MR. FURST LACKS CAPACITY AND STANDING TO BRING THE MOTION ON BEHALF OF OTHER INVESTORS**.

Mr. Furst attempts to speak on behalf of other "Pass-Through Investors" even though he is not their attorney and has no authority to do so. As the Court will remember, Mr. Furst filed a Motion over a year ago purporting to speak on behalf of the Mortgages Ltd. Employee 401(k) Plan. ML Manager filed a Motion to strike and it was granted by the Court. While he is an attorney, Mr. Furst does not practice law and does not represent the Pass-Through Investors in the Vistoso Loans in any capacity. Further, ML Manager is the Agent for these Investors and has been given "sole discretion" to act on their behalf. Thus any and all requests on behalf of the Pass-Through Investors in these loans made by Mr. Furst must be stricken and denied.

4. **MR. FURST GRANTED ML MANAGER, AS HIS AGENT, "SOLE DISCRETION" TO ACT ON HIS BEHALF AND HE HAS NO CAPACITY OR STANDING TO BRING THIS MOTION.**

ML Manager is the Agent for Mr. Furst and/or his retirement plan and as such has fully authority and power to act in its "sole discretion" on decisions related to the loans and the properties. Mr. Furst as a Pass-Through Investor in the Vistoso Loans is bound by an agency agreement and subscription agreement. This fact is undisputed. It is the same agreement that has been reviewed by the Court on numerous occasions in this bankruptcy case over the last 3½ years. It is an irrevocable agency with power of attorney coupled with an interest. ML Manager does not follow his instruction but is expected to exercise

its business judgment on behalf of all the investors in the loans.

The Court has ruled on these issues on numerous occasions with respect to Mr. Furst. Law of the case and res judicata prevent Mr. Furst from continuing to relitigate such issues. Mr. Furst does not like or agree with the decisions and nonetheless continues to raise them. The Court's ruling on the University & Ash motion in November 2008, Mr. Furst had filed a Statement of Position on the authority and agency issues in that proceeding and his objection and position were overruled by the Court. The Court sustained the business judgment of the Agent (which at the time was Mortgages Ltd.) and ruled that Mortgages Ltd. had the authority to proceed whether the investor consented or not. In May of 2010, Mr. Furst objected to the sale of VBC property and joined with others represented by Rick Thomas to file a partition action. The Court overruled the objections on the merits, ruled that ML Manager had the authority as the Agent to proceed, sustained the business judgment of the Agent, approved the sale and ruled that partition would not be appropriate. Unfortunately the sale did not close and problems arose about the title. In November 2011, Mr. Furst again objected to the sale of the VCB property and raised the question of authority. The Court overruled the objection on the merits, ruled that ML Manager had the authority as the Agent to proceed, sustained the business judgment of the Agent, and approved the sale.

Given that the investors have granted the Agent full irrevocable authority to act on their behalf which shall be exercised in Agent's sole discretion, the question is whether the Agent has to follow the instruction of the principal. The Court has already ruled on this issue and said no. The Court has said repeatedly in exercising its duties and responsibilities ML Manager is to use its business judgment based on the facts and circumstances. Thus, based on law of the case and res judicata principles, the Court should deny the Motion.

5. <u>THE MOTION IS NOT BROUGHT TO CLARIFY RIGHTS UNDER THE PLAN OF REORGANIZATION</u>.

Mr. Furst has couched the Motion as one in which he seeks a "declaration of rights

under the Plan of Reorganization". However, he cites no Plan provisions that need to be clarified or rights granted under the Plan that need to be interpreted by the Court. As the Court is well aware, the Confirmed Plan and Confirmation Order expressly provide for the assignment of the existing agency agreements, subscription agreements and other documents to ML Manager. There were no modifications to the existing agency agreements. Paragraph U(1) of the Confirmation Order states that there are no changes to the agency documents. Therefore, what Mr. Furst really seeks is to change or impose new duties under the Agency Agreement by using the Confirmed Plan as an excuse.

To the extent he seeks to modify the Confirmed Plan and impose new rights and duties that are not contained in the Confirmed Plan, it is not possible at this late date. The Confirmed Plan has been substantially consummated and cannot be modified. The District Court has ruled on this issue in one of the pending appeals. Thus to the extent the Motion is one that seeks to modify the Confirmed Plan it must be denied.

6. **TO THE EXTENT MR. FURST CAN PURSUE THE MOTION ON HIS OWN BEHALF, IT MUST BE DONE BY ADVERSARY PROCEEDING**.

As presented, the Motion is procedurally improper. If Mr. Furst is seeking a declaratory judgment, then the only way for Mr. Furst to proceed is to file an adversary proceeding under Federal Bankruptcy Rule 7001(9). The Federal Rule clearly explains that a request for declaratory relief under a plan of reorganization is an adversary proceeding. Fed. R. Bankr. P. 7001(9). The Bankruptcy Appellant Panel has interpreted this Rule 7001, Federal Rules of Bankruptcy Procedure, as requiring an adversary proceeding. *Ung v. Boni (In re Boni)*, 240 B.R. 381, 385–86 (9th Cir. BAP 1999); *see also In re Munoz*, 287 B.R. 546, 551 (B.A.P. 9th Cir. 2002) (holding that the failure to hold an adversary proceeding was error). Specifically in *Boni*, the Appellate Panel recognized that an adversary proceeding provides the parties with certain rights and protections that are not available in contested motion including formal pleading and a structured pretrial process. *In re Boni*, 240 B.R. at 385-86.

Here, the Motion attempts to bypass the protections provided by the procedural rules. Because Mr. Furst' Motion is procedurally insufficient to provide ML Manager with the protections provided by an adversary; the Court must deny the Motion.

7. MR. FURST'S MOTION IS SUBSTANTIVELY WITHOUT MERIT.

In addition to its procedural problems, the Motion is also substantively without merit. The Motion requests four separate declarations regarding alleged rights that Mr. Furst claims in some of the loans. These declarations include declarations that: 1) Manager has a "fiduciary duty" to schedule meetings to provide pass-through investors the opportunity to decide to hold the property; 2) ML Manager has a "fiduciary duty" to provide pass-through investors with contact information of other pass-through investors; 3) ML Manager has a "fiduciary duty" to submit the pass-through investor proposed partitions to the Loan LLCs for approval; and 4) the pass-through investors have a "right" to seek judicial partition of the property. Obviously, these are not "declarations," but an effort to impose additional duties and obligations on ML Manager not embodied in the Confirmed Plan or in the Agency Agreements or Operating Agreements. Indeed, at the heart of these issues is a request to undo the operation of the Agency Agreements that were assigned to ML Manager and replace it with tasks and new duties and responsibilities for the Agent. There are no such fiduciary duties or rights within the Agency Agreement. However, it is clear from the language of the Confirmed Plan as well as the testimony at the Confirmation Hearing that Mr. Furst is not entitled to the relief he is requesting. Accordingly, the Court should deny the Motion.

Stated basically, the Motion seeks a general declaration that ML Manager has a fiduciary obligation to provide the Pass-Through Investors with a "right to partition" and hold a portion of two separate properties. At best, this is a request that the Court modify the Confirmed Plan. It is a modification because it changes the rights of the various creditors and could have affected the way that people acted following the confirmation of the Confirmed Plan. As the Court will recall, there was a short window of time given for Pass-Through Investors to decide if they wanted to transfer their interests into the Loan

LLCs, or remain outside and subject to the Agency Agreements. This window was a requirement imposed by the SEC because of the various concerns related to the nature of the investments involved. One of the concerns that some Pass-Through investors had was that the assets of the Loan LLCs were to be pledged as security for the exit loan. On the other hand, the operating agreement for the Loan LLCs gave the members of the Loan LLCs a vote on "Major Decisions" such as the sale of property, or compromise of debt. Some Pass-Through investors felt that a voice in management was worth the risk of the pledge of their assets as security. Others did not. Now that the interest bearing portion of the exit loan has been repaid, and almost all of the non-interest bearing portion has been paid, Mr. Furst wants to modify the operation of the Confirmed Plan. This is unfair to those who relied on the Plan as drafted and implemented. Moreover, the District Court has already ruled that the Confirmed Plan has been "substantially consummated." As such, modification of the Confirmed Plan is no longer available under any circumstances.

Mr. Furst's request is also contrary to the intent of the Confirmed Plan. As the Court has indicated on several occasions, this was essentially a Plan to provide for an orderly liquidation. As such, it is clear that the Confirmed Plan does not provide for or even allow individualized control. Individual control is not permitted under the Confirmed Plan or the existing Agency Agreements. The Motion completely ignores the choice that the Pass Through Investors made to retain their interests subject to the existing Agency Agreements. The Confirmed Plan was clear and the testimony supporting it unequivocal – Pass-Through Investors who did not transfer their interests to the Loan LLCs were bound by the Agency Agreements they negotiated with Mortgages Ltd. Indeed, the Disclosure Statement supporting the Plan clearly stated:

> If a Pass-Through Investor decides not to transfer an interest into the applicable Loan LLC for a specific Loan . . . [t]he benefits and protections of the Loan LLC and the use of the Exit Financing will not be available to such Pass-Through Investor and such Pass-Through Investor **will be subject to the existing Subscription and Agency Agreement fees and provisions which will be enforced by the ML Manager LLC** . . . .

Disclosure Statement at 8 [Docket No. 1531] (emphasis added). Additionally, during the confirmation hearings on the Confirmed Plan the proponents' primary witness, Ed McDonough reiterated that one of the features of the Confirmed Plan was that Investors who transferred their interests into the new Loan LLCs would have a right to vote on management decisions, but that Pass-Through Investors who did not transfer would be subject to the Agency Agreements and ML Manager's decisions. May 18, 2009 Transcript at 90-94 [Docket No. 2136]. Specifically, Mr. McDonough stated during cross-examination:

> Q. Now, let's turn to the investors who have retained their notes and deeds of trust. How is their servicing handled?
>
> A. Their servicing is going to be handled no different than the others. ML Servicing is going to be servicing the notes and deeds of trust.
>
> **Q. And will they be subject to the current agency agreements?**
>
> A. **I believe that's the idea**, that the agency agreements will be assigned that's my term, not a lawyer term -- to ML manager (sic), and that somehow that that will be they'll have the ability then to service the loan under the concept of the agency agreement for the benefit of the notes and deeds of trustholders who did not put their notes and deeds of trust into the LLC.
>
> * * *
>
> Q. So let me see if I understand this correctly. Part of the benefit you have indicated for the investor plan is that the LLC's will have investor control; correct?
>
> A. That's correct.
>
> Q. And they'll be able to vote on major decisions?
>
> A. That's correct.
>
> **Q. But the investors who have retained their notes and deeds of trust don't have the ability to vote on major decisions do they?**
>
> **A. No. That's one reason why we asked - - suggest they hop into the LLC's because it gives them a voice, more of a voice than they have now.**
>
> * * *

> Q. And maybe we'll just go back and start from the beginning. The LLC's have the ability to say vote to sell a note; correct?
>
> A. Well, the LLC members if you would?
>
> Q. Yes.
>
> A. The LLC members have the right to basically accept or reject what the board is suggesting should be done with that note. So the board uses its business judgment, as to whether or not to sell- this note for 65 cents on the dollar. And then they make their business case to the investors who then in the LLC's say yea or nay. Okay? So the LLC's, it's a top down, not a bottom up.
>
> Okay? So they make their business case. Because the board, in my view, would only make the business case if they thought that was the best thing to do. So they make their business case.
>
> If it's thumbs up, it gets sold. If it's thumbs down, it doesn't.
>
> **Q. And then what happens to the investors who did not agree to transfer their notes and deeds of trust? Are they bound by the determination of the LLC?**
>
> **A No. They're bound by the decision of the LLC board through the agency agreement. And we believe the agency agreement allows them to basically get the right to liquidate the note.**
>
> So the board, if you would, is making their decision as agent, and that's the decision that's being made for the folks that don't opt in, if you would, or put their LLC in. But what can't happen is they can't say, "Well, I guess, you know, we're going to sell the LL- the folks that aren't in, because we can, but the other ones voted against it." Okay? So it's all or nothing.
>
> But the agency agreement that gives the manager, if you would, or the agents their rights and provisions that currently exist, those will continue. And if in their business judgment the best thing to do would be to do X, that's the document that allows the LLC then to make that decision as the agent for the notes and deeds of trustholders who did not put their money into the LLCs. They put it in. They now have a vote.

Id. This testimony was clear. The Court confirmed the Plan. All objections were either resolved or withdrawn or overruled. No party appealed. This Court has already confirmed on numerous occasions that ML Manager has the agency authority to deal with the loans. The Pass-Through Investors remain bound to that same agency authority as a result of their decision not to transfer their interest into the Loan LLC. Accordingly, Mr. Furst is

not entitled to the declaration he is seeking as a matter of law and the Court should deny the Motion.

WHEREFORE, ML Manager requests that the Court deny the Motion for the reasons stated above.

RESPECTFULLY SUBMITTED this 1st day of March, 2012.

FENNEMORE CRAIG, P.C.

By */s/ Cathy L. Reece*
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COPY of the foregoing mailed and emailed this 1st day of March, 2012 to:

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