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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 MANAGER'S (1) NOTICE OF LODGING ALLOCATION MODEL TO BE USED WITH REGARD TO THE DISBURSEMENT OF PROCEEDS TO THE NEWMAN LOAN INVESTORS, (2) NOTICE THAT ALLOCATION MODEL HAS GENERAL APPLICABILITY TO ALL INVESTORS, And (3) MOTION TO APPROVE ALLOCATION MODEL** **Hearing Date: Sept. 21, 2010** **Hearing Time: 1:30 p.m.**

As has been discussed in many different contexts in this matter, the question of the "Allocation Model" for the payment of costs and expenses is an important predicate issue prior to making distributions Investors.[1] Although this issue has generally applicability to all ML Loans and all Investors, it has initial application in the distribution of proceeds to the Investors in ML Loan #7987S2 (the "Newman Loan"). The borrower under the Newman Loan has paid off all amounts due. As demonstrated below, the Plan requires

[1] To the extent defined in the First Amended Plan of Reorganization as confirmed by the Court, (*see* Docket Nos. 1532 (the, First Amended Plan), 1755 (Confirmation Order)(collectively hereinafter, the "Plan"), defined terms herein shall have the same meaning as set forth in the Plan.

that before disbursing money to the Newman Loan Investors,[2] or any other Investor ML Manager must first assess them their proportionate share of all costs and expenses, including the Exit Financing (collectively, "Costs"), in a fair, equitable and non-discriminatory manner.

In determining a proportionate share of all Costs in a fair equitable and non-discriminatory manner, there are many issues that arise. For example, the total amount of Costs is not yet known and it is also not known for sure how many of the loans will produce a recovery sufficient to cover their share of the Costs. There are many issues to consider on what constitutes a "General Cost" that the Plan contemplates will be spread across all Investors, and a loan "Specific Cost" that is to be allocated to particular loans. ML Manager has spent literally hundreds of hours, employed accounting and legal professionals, and considered everything from small details or implications to large macro philosophies. ML Manager, by unanimous vote of the ML Manager Board, has now adopted a model to estimate and allocate all the Costs associated with each of the ML Loans (the "Allocation Model") that it believes, in the exercise of its business judgment, meets its obligations and is fair, equitable and non-discriminatory. Once the Allocation Model has been approved, ML Manager can apply the Model to the Newman Loan Investors. Until then, in order to provide for any contingencies that may arise during the process of approving the Allocation Model, and pursuant to the Court Order to disburse the undisputed amount, ML Manager has disbursed to most of the Newman Loan Investors, approximately 80% of the amount received from the pay-off of the Newman Loan. This should leave sufficient cushion for any adjustments that should be made in the Allocation Model.

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[2] The Investors in the Newman Loan are collectively, the "Newman Loan Investors." The Newman Loan Investors and the amounts of their respective investments in the loan is set forth on Exhibit A.

I. PROCEDURAL BACKGROUND

On June 2, 2010, one of the investors in the Newman Loan filed a motion seeking an order compelling the turnover of proceeds from the Newman Loan. (Docket 2771) Following a hearing on June 30, 2010, the Court issued an Order requiring ML Manager by September 1, 2010 to complete its analysis on how to allocate costs and expenses to the Newman Loan Investors, distribute to the Newman Loan Investors their undisputed share of the proceeds from the Newman Loan,[3] and provide to the other Investors that were in a similar situation notice of the methodology of the Allocation Model (*See* Docket No. 2802) (the "Newman Loan Order). In the Newman Loan Order, the Court set a briefing schedule and a hearing date to consider the issues surrounding the "accounting of the charge back amount and the methodology as to how the amounts were determined." (*Id.*) ML Manager believes that the Allocation Model fulfills this obligation.

Pursuant to the Court's instruction, ML Manager hereby provides notice of its intent to make, as soon as the Allocation Model is approved by the Court, a net distribution to the Newman Loan Investors as set forth in Exhibit A.[4] This net distribution was calculated through the Allocation Model by estimating, based on ML Manager's business judgment, the "Total Expected Costs" (as defined below) for the Newman Loan Investors, as well as all other Investors.[5]

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[3] Because the Allocation Model spreads the Costs based on certain assumptions, a final decision on how much to distribute to the Newman Loan Investors necessarily requires an approval of the methodology adopted in the Allocation Model. Accordingly, ML Manager has distributed approximately 80% of the proceeds from the Newman Loan (except as noted below) in order to leave sufficient cushion for any adjustments that are required as a result of the consideration and approval of the Allocation Model.

[4] The net distribution made after the Court approves the Allocation Model will be the difference between the amount set forth on Exhibit C (or some other amount if the Court orders changes to the Allocation Model) and the approximate 80% of the proceeds that have already been distributed.

[5] As further events warrant, there may be some additional money that can be distributed to all Investors, including the Newman Loan Investors. Primary among these issues would be if the velocity of recovery is quicker than currently estimated, if costs are less than currently estimated, and/or if more loans are able to cover their share of costs than currently estimated. If that is the case, there additional distributions may be warranted.

Separate from the Allocation Model is the issue of whether ML Manager has claims against an Investor. As explained below, the Agency Agreements that govern the relationship with Newman Loan "Pass-Through" Investors and all other Pass-Through Investors provide that the Investors are responsible and must indemnify ML Manager for the costs and damages they have caused. As explained in more detail below, ML Manager has a claim for offset or recoupment under these provisions against at least one of the Newman Loan Investors, Rosenfield. Accordingly, ML Manager has caused the escrow agent to hold in an interest bearing account, pending final resolution of the offset and recoupment issues, the distributions to Rosenfield.

As discussed below, ML Manager believes that in general the Allocation Model applies to all Investors. Accordingly, pursuant to the direction from the Court, ML Manager further provides notice that it believes that this general Allocation Model applies to all Investors and that it intends to proceed in the future by utilizing this Allocation Model.[6] Pursuant to the Newman Loan Order, any objections to the utilization or implementation of the Allocation Model must be asserted by September 10, 2010, with a hearing held on September 21, 2010. Finally, pursuant to the reservation of jurisdiction under the Plan of Reorganization for this Court to resolve any disputed matters, ML Manager hereby moves for an Order from the Court approving this Allocation Model.

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[6] The Mortgages Ltd. 401(k) Plan (the "401(k) Plan") has recently filed a number of pleadings and documents asserting that they are not liable for Costs, and has, among other things, asked this Court to abstain from ruling on the issue until the forum for resolution of this issue can be determined. ML Manager recognizes that the issue of whether the 401(k) Plan is liable for Costs has not yet been determined by any court. Accordingly, ML Manager has an Allocation Model that includes the $22 million in loans owned by the 401(k) Plan, and an Allocation Model that excludes the 401(k) Plan interest in those loans. Several other Investors, such as the Rev-Op Group, have asserted that they also are not liable for the Exit Financing. ML Manager believes that there are final judgments or decisions by this Court on all of those issues, so no other version of the Allocation Model has been created to eliminate other Investors. Indeed, exclusion of a substantial number of Investors from the Allocation Model would materially affect it and potentially frustrate the entire exercise. However, if further rulings or decisions were rendered by this Court or an appellate court, the Allocation Model would need to be adjusted.

Inasmuch as ML Manager has provided notice that it believes that this Allocation Model is an appropriate exercise of its business judgment, fulfills all of ML Manager's obligations and duties related to this subject, and generally applies to all Investors, any objections to this general Allocation Model should be asserted and resolved at this time, and any unasserted objections to the Allocation should be barred in the future.

One key assumption in the Allocation Model is that all Investors (including the so-called Non-Transferring Pass-Through Investors, the MP Fund Investors, the Rev-Op Investors, the Loan LLC Investors, or the 401(k) Plan) are liable for their fair share of the Costs and are subject to the Allocation Model. If any group is taken out then the Total Cost Estimates numbers would necessarily increase for all remaining Investors. Therefore, ML Manager has decided that as the Court considers the amount that can be allocated to the Newman Loan Investors that the Court should have the complete picture. There are a few other pending matters brought by the 401(k) Plan, Robert Furst, the Rev-Op Group, some or all of the Oxford Partners Group and the Guillorys that might have an impact on who is allocated their fair share of the Costs. The rulings on those matters and any appeals from those matters could impact this Allocation Model. Accordingly, rather than litigate those Allocation Model issues in a piecemeal fashion, ML Manager has decided to provide this Notice and Motion to all Investors.

II. BUSINESS JUDGMENT

The business judgment test is the applicable standard to be applied to the Allocation Model, and it is clear that ML Manager has satisfied this standard.

A. The Applicable Test for Evaluation of the Allocation Model Is The Business Judgment Test

Both factually and legally, the test to be employed to determine the appropriateness of the Allocation Model is the business judgment standard. The business judgment rule is that the officer and directors of a corporation[7] are authorized to handle the ordinary business affairs of the corporation according to their best judgment. *Tovrea Land and Cattle Company v. Linsenmeyer*, 100 Ariz. 107, 129-30, 412 P.2d 47, 62 (1966)(*quoting Fagerberg v. Phoenix Flour Mills Co.*, 50 Ariz. 227, 71 P.2d 1022 (1937). *See also, Resolution Trust Corp. v. Blasdell*, 930 F. Supp. 417, 423-24 (D. Ariz. 1994)("The business judgment rule, stated generally, 'precludes judicial inquiry into actions taken by a director in good faith and in the exercise of honest judgment in the legitimate and lawful furtherance of a corporate purpose.' *Shoen v. Shoen*, 167 Ariz. 58, 804 P.2d 787, 794 (Ariz. Ct. App. 1990); see *Kadish v. Phx. Scotts. Sports Co.*, 11 Ariz. App. 575, 466 P.2d 794, 797 (Ariz. Ct. App. 1970). The rule thus applies if directors act in furtherance of a legitimate corporate purpose, in good faith, and after reasonably informing themselves. *See, e.g., Blumenthal v. Teets*, 155 Ariz. 123, 745 P.2d 181, 186 (Ariz. Ct. App. 1987) (*citations omitted*). *See also FDIC v. Jackson*, 133 F.3d 694, 699, fn.5 (9th Cir. 1998)("It is the general rule that officers and directors of a corporation are authorized to handle the ordinary business affairs of the corporation according to their best judgments…")(*quoting Fagerberg v. Phoenix Flour Mills Co.*, supra.)

The Plan, the evidence presented at the confirmation hearings, and the Court's prior Orders also establish that the standard that ML Manager must meet and was contemplated that ML Manager would meet in order to faithfully discharge its obligations to the Investors and under the law in determining issues surrounding an Allocation Model for the payment of costs and expenses and distribution of money to the Investors is the business judgment test. For example, during the evidentiary hearing on the confirmation of the Plan, Ed McDonough testified that ML Manager's decisions would be based on

[7] To analyze the duties in a limited liability company, Arizona looks to authorities on corporations. *See Nutek Info. Sys., Inc. v. Arizona Corp. Comm'n*, 194 Ariz. 104, 106, 977 P.2d 826, 828 (App. 1998)(noting characteristics of a limited liability company that are equivalent to those in other types of organizations).

their business judgment. *See e.g.,* May 18, 2009 Transcript (Docket 2136), at p. 92-93. The Plan provides that ML Manager shall be formed pursuant to an operating agreement substantially in the form attached to the Disclosure Statement as Exhibit M. With regards to disbursements, Exhibit M to the Disclosure Statement provides that "Cash Available for Distribution, if any, shall be available for distribution to the Members, at such times as the Manager [the ML Manager Board] may determine in its sole discretion." (Exhibit M to Disclosure Statement, at § 3.1(a)). *See also id.,* at §§ 5.2(a), 5.3. The Court's Confirmation Order (Docket 1755) provides:

> G. …The Board of Manager [ML Manager's Board], through any manager authority by the Board [**ML Manager] are authorized to execute any document necessary to effectuate and implement this Order, the Plan** and this paragraph.
>
> H. The proposed Exit Financing is approved and the Liquidating Trust, the **ML Manager LLC**, the MP Funds, and the various Loan LLCs **are authorized to enter into Exit Financing and take all actions necessary to effectuate such Exit Financing, including but not limited to, executing the necessary loan documents to implement Exit Financing, entering into an interborrower agreement**, and pledging their assets. …
>
> I. The Plan Proponents, Liquidating Trustee, **ML Manager** LLC, Reorganized Debtor and Debtor **are authorized, empowered and directed,** without further order of the Court, to execute and deliver any instrument, security agreement, deed of trust, or other document and **to perform any act that may be necessary, desirable or required for the consummation of the Plan** (emphasis added).

By authorizing ML Manager to take any action necessary or desirable to effectuate the Plan, the Court essentially authorized ML Manager to exercise its business judgment.

In its Memorandum Decision (Docket, 2323) issued on October 21, 2009 in connection with the Rev-Op Group's Motion for Clarification, the Court found as follows:

> 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**. (emphasis added).

In its Order Approving the Grace Settlements (Docket 2825), issued on July 12, 2010, the Court found as follows:

> (e) The Settlements and ML Manager's decision to enter into the Settlements reflect a reasonable compromise of the complex issues involved, are in the best interests of the investors in the Grace Entities Loans, **are supported by the best exercise of business judgment of ML Manager and are consistent with ML Manager's fiduciary duties and responsibilities**. (emphasis added).

The Court found in issuing its Final Declaratory Judgment on July 27, 2010 in Adversary 2:10-ap-00430-RJH (the "Hawkins Adversary") (Docket 105) that:

> 85. With regard to the issues raised by the Rev-Op Group in their Declaratory Judgment Action, the Court finds **that ML Manager has the authority, subject to provisions of the Plan and Confirmation Order and a possible review by the Court under a business judgment standard**, to (i) sell or liquidate any investor's interest, which includes the Rev-Op Group's respective interest, in the ML Loans if the investor owns less than 100% interest in any Loan, (ii) initiate and complete a judicial or non-judicial foreclosure or trustee's sale of property secured by the ML Loans, (iii) settle, compromise or modify the terms of the ML Loans or guarantees associated with the ML Loans pursuant to the terms of the Agency Agreement and the Plan, (iv) initiate and complete a sale of real property in which the Rev-Op Group has an interest provided that more than one investor has an interest in such property, and (v) **incur and seek to recover from the Rev-Op Group in a proportionate, non-discriminatory, fair and equitable manner any costs and expenses associated with the management of the ML Loans including, if necessary in ML Manager's reasonable discretion, additional indebtedness**. (emphasis added).

Based on the applicable legal principals, the prior Court Orders, and the provisions of the Plan and Confirmation Order, the applicable test to determine the appropriateness of the Allocation Model is the business judgment standard. In other words, the applicable test is whether the decision to adopt the Allocation Model was taken in good faith, whether it is a legitimate and lawful exercise of ML Manager's authority, whether ML Manager informed itself of the issues, and whether it exercised business judgment.

B. <u>The Business Judgment Test Has Been Satisfied.</u>

There can be no serious debate as to whether the business judgment test has been satisfied in this case. The Plan contemplates that a large portion of the Exit Financing and general costs would be paid by the Liquidating Trust. However, at the present time, the Liquidating Trust has yet to recover any significant amounts from claims against third parties. ML Manager is hopeful that over time the Liquidating Trust will successfully recover amounts from third parties and will be able to pay some or all of the Costs and that will allow additional money to be returned to the Investors. Nevertheless, ML Manager cannot assume at this time that any amount of the Exit Financing will be paid by the Liquidating Trust. ML Manager, the ML Servicing staff, and ML Manager's professionals and advisors have spent literally hundreds of hours analyzing and considering numerous issues in a very complex situation. ML Manager began working on the issues related to "charge-backs" and allocating costs and expenses more than a year ago. There were many viewpoints to consider and these competing viewpoints were often disparate. ML Manager has taken great care to consider as many issues as possible in arriving at this Allocation Model. In so doing, the ML Manager Board has been able to finally arrive at a consensus approach and after hours of deliberation at Board meetings and it has **<u>unanimously</u>** adopted the Allocation Model.

As noted above, there have been literally hundreds of hours devoted to this subject. The ML Manager Board considered the issues for over a year. There were many, many Board meetings devoted to the issues. A separate sub-committee of the Board was formed to analyze the issues. ML Servicing staff was extensively involved and spent hundreds of hours. Previous reports and prior analysis of the experts and professionals hired were reviewed. Additional, experts and professionals were retained who were completely independent of the prior experts and professionals retained by the Official Investors Committee, including Simon Consulting, LLC -- Peter Davis, CPA/ABV, CIRA, CFE. Almost all of the various legal counsel employed by ML Manager were also consulted in connection with some or all of the issues involved.

All of the operative documents were reviewed and considered including the Plan, the Disclosure Statement, the Confirmation Order, and the governing documents for the Loan LLCs, ML Manager and other entities. The Exit Loan documents were also reviewed, including the loan agreements and the interborrower agreement referred to in, among other places, paragraph H of the Confirmation Order described above (the "Inter-Borrower Agreement"). Already incurred costs, projected budgets and all projections or estimations were reviewed and analyzed. Substantial information regarding the value of the assets including all previously created appraisals, valuations, and new Broker's Opinions of Value and marketing information were reviewed. Finally, lengthy Board meetings were held where the analysis, assumptions, projections, treatment and other information was considered, reviewed and discussed at length. In short, there were and are many moving pieces that have been evaluated, considered and implemented.

Moreover, ML Manager has had to make these decisions at a time when the country and the local real estate and lending markets have undergone possibly the greatest financial upheaval since the end of World War II. The list of unknowns and uncertainties is great and includes, without limitation, the following:

> A. Asset values have fallen significantly and may fall further and no one knows when or if there will be a recovery in the price of the assets during the Disposition Period.
>
> B. The length of Disposition Period is unknown since the velocity at which the assets can be sold depends on a number of factors which the ML Manager cannot control, including the interference or distraction caused by certain Investor objections to almost every action taken by ML Manager.

C. The current value of the real estate underlying the Loans cannot be determined with any degree of accuracy in the absence of actual offers from reputable buyers. Appraisals are expensive and not very helpful because they rely on past data and the market has continued to move. In addition, the ML Manager does not believe that it is an efficient utilization of resources to pay for appraisals of all of the assets at this time. ML Manager has spent considerable time evaluating and analyzing the properties, has obtained broker's opinions of value on many of the properties, and undertaken all actions that it deems prudent to evaluate the current value. Nevertheless, given the instability of the market, a determination of current value for all of the properties is extremely difficult.

D. There are unknown factors that limit or inhibit ML Manager's ability to manage the Loans and the Trust Property. For example, even after sale agreements have been approved by the Court and Loan LLCs, several have not closed due to the buyers backing out. When negotiating a sale contract, it is not known at the time whether the members of the Loan LLCs will vote to permit a particular sale. The complications in the sale process makes some buyers less interested. There have been issues raised with regard to loan documents and legal descriptions. City, County and other governmental regulations may pose an issue. Third parties have asserted claims such as mechanic lien claims and vendee liens. If sales are not approved, then the Disposition Period will be extended and there is a real possibility that the ML Manager may be unable to meet the required reductions in the maximum outstanding balance and the Exit Financing Lender may require sales of assets as permitted by the Exit Financing Documents which may result in lesser recoveries that the normal sale process.

E. The amount of litigation that the ML Manager on behalf of Investors may become involved in, and the number of bankruptcies of Borrower and Guarantors which may occur, and the costs thereof, cannot adequately be forecasted. As an example, the amount of professional fees claimed in the Bankruptcy far exceeded the reasonable estimates based on best information available at the time that was presented to the Court in the Plan confirmation process. In addition, until the claims by a small number of the Rev Ops and others claiming that they are not subject to the Agency Agreements and should not be required to pay for the Exit Financing are finally decided there will be some uncertainties, so it is not possible to determine the actual pool of assets from which the recovery will ultimately be paid.

F. Since the length of the Disposition Period cannot be

> determined for the reasons set forth above, the ML Manager will be unable to accurately forecast the total amount of Costs that will be incurred. Each year of delay in disposing of the assets raises the Costs substantially.

Given all of the foregoing unknowns and uncertainties, the only thing that the ML Manager Board can do is to exercise its business judgment to estimate all of the various variables that go into determining all of the required items necessary to make an initial and subsequent estimates of the costs, the possible recoveries in total and by each of the ML Loans, and to re-evaluate the estimations from time to time as more definitive data becomes available.

ML Manager recognizes that reasonable men could differ on various factors and forecasts that go into making such estimations, however, ML Manager does not believe that that is the test. In terms of withholding from distributions to Investors whose assets has been sold, the Board recognizes that money distributed to Investors cannot, as a practical matter, be recovered if it turns out that the estimated Costs are too low. Therefore the duty to Investors whose assets will be sold later requires that the Board be conservative and establish sufficient amounts to provide a reasonable margin of safety. The estimations are a matter of business judgment and the more unknowns and uncertainties exist, the greater the margin of safety that must be adopted. This decision is necessary to protect all Investors.

In short, ML Manager has taken extremely seriously its obligations and expended considerable time, effort, and resources to determine the proportional amount of the costs and expenses to allocate to all Investors in a fair, equitable and non-discriminatory manner. Whether someone else would have come up with a different method is not the issue. The only issue is whether ML Manager exercised its business judgment in adopting the Allocation Model, and the answer to this question is clearly, Yes.

III. THE ALLOCATION MODEL

Based on the operative provisions of the Plan, the agreements that have been entered into, such as the Inter-Borrower Agreement, and ML Manager's determination of what is necessary to constitute "fair, equitable and non-discriminatory treatment," ML Manager determined that there are three necessary prerequisites for the Allocation Model.

A. The Goals of the Allocation Model

First, the Allocation Model must apply to all or as many Investors, participants or owners of the loans that were at issue in the Mortgages Ltd. bankruptcy as possible. Exclusion of any group or groups simply shifts and increases the costs on remaining Investors. The total amount of the ML Loans accounted for in the Allocation Model is the total amount of the portfolio.[8] This includes all owners of the loans that were subject to, embroiled with, entangled with or otherwise impacted by the Mortgages Ltd. bankruptcy proceedings. All owners of these loans were affected or benefited by the resolution of the bankruptcy, the termination of the accrual of administrative expenses, and the confirmation of the Plan. As such, it is ML Manager's position that all owners of the ML Loans must pay their fair share of the Costs in a fair, equitable and non-discriminatory manner. At the same time, the Allocation Model provides that once the Total Estimated Costs are paid for any particular Loan, the Investors in that Loan are no longer responsible for any additional accruing interest to either the Exit Lender, or, as defined below, the Replacement Loan Lender or the Permitted Reserve Loan Lender. In other words, once the Total Estimated Costs are paid, the Investors who have paid those costs have paid their fair share and are not responsible for further interest. They may be entitled to receive interest as described below, but they will not be required to pay additional interest.

The next principle is that all payments of the costs will be made from

[8] As noted above, because of the fact that there has been no resolution of the issue of whether the 401(k) Plan is included or not, ML Manager has run the Allocation Model with the 401(k) Plan interest in loans included, and its interest excluded.

disbursements. One of the features of the Plan as it was presented to the Investors for a vote, presented to the Court during the confirmation hearings, and included in the provisions of the Plan, was that there would be no mandatory capital calls. *See e.g.*, May 18, 2009 Transcript (Docket 2136), at p. 103. Repayment solely from disbursements was expressly set forth in both the proposed and final versions of the Operating Agreements for the Loans LLCs.[9] (*See* Exhibit K to the Approved Disclosure Statement, at ¶ 2.3) In other words, the Plan recognized that the Investors have already suffered significant losses, and that no Investor should be required to write an additional check. Although most of the loans are secured by a first position in real property that has value (albeit sometimes substantially less than the amount of the loan), the collateral for some of the loans may have no value at all, or insufficient value to pay the full share of Costs. This is particularly true for loans in a second or third position. So the Allocation Model must recognize and provide for what is called "Uncovered Costs."

Finally, the proportionate share of the Costs, or "Cost Sharing Ratio" should be based on the ratio of the principal balance of a loan as of the date of bankruptcy to the entire portfolio balance. There are many reasons for this. For example, it leaves the risk of the performance with the individual loans, which is important because some investors specifically investigated and identified their loans. Moreover, final recoveries will not be known until the conclusion of the disposition of all of the loans, the deficiency lawsuits, and resolution of the Investor Damage claims in the Liquidating Trust. Obviously, disbursements should not be held for years waiting final disposition of those issues. Furthermore, the Inter-Borrower Agreement between the Loan LLCs requires this method

[9] This is not to assert that Investors in any particular Loan could not agree to pay the Total Estimated Costs and use their own funds for this purpose. Depending on the individual circumstances, ML Manager is generally willing to negotiate an agreement to terminate the Agency Agreement for any particular Loan upon the payment of the Total Estimated Costs for that Loan. As a practical matter, the effect of such an agreement would be to terminate responsibility for accruing interest.

of sharing of costs between the Loan LLCs. Because the Confirmed Plan requires that Pass-Through Investors be treated in the same fashion as Loan LLC Investors, and the Inter-Borrower Agreement requires the Loan LLCs to allocate Costs in this fashion, this methodology is necessarily required.

In short, the fundamental premise or foundation for the Allocation Model is that all or as many as possible of the Investors or owners of the ML Loans that were entangled in the Mortgages Ltd. bankruptcy should pay their fair share of costs and expenses from distributions received from the loans or from the disposition of those loans. There are no free rides. Costs are paid from disbursements of proceeds received from the Loans so that no Investor is required to write an additional check, and the proportionate basis for the Cost Sharing Ratio is the initial principal balance of a particular loan to the entire portfolio on the date of bankruptcy as then adjusted to allocate Uncovered Costs. For the Loans where it is currently assumed that there will be a sufficient recovery to cover their full share, the Allocation Model is that the share of General Costs is slightly more than 3% of the principal balance of the Loans. The Specific Costs depend on the costs associated with each individual Loan.

B. <u>The Reason and Textual Support For The Allocation Model</u>

ML Manager is required to allocate the costs and expenses ("Costs") incurred in connection with serving and collecting the ML Loans and properties which it oversees both in its capacity as a manager of the Loan LLCs which have an interest in such Loans and as agent for the Pass-Through Investors and others (collectively, the "Pass-Through Investors") who did not transfer their participating interest in the Loans to a Loan LLC.

Section 4.13 of the Plan, as modified by paragraph U(3) of the Confirmation Order provides as follows:

> 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. Any Pass-Through Investor that does not transfer its fractional interest into a Loan LLC will receive its distribution pursuant to the existing Agency Agreement and other contracts which may be assigned to the ML Manager LLC. <u>Before such distributions are made, Pass-Through Investors who retain their fractional interests in the ML Loans shall be assessed their proportionate share of costs and expenses of 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</u>. (emphasis added).

The Operating Agreements for the Loan LLCs (and the Operating Agreements for the MP Funds, as amended) all provide for distributions to their members after payment of all the applicable costs and expenses. Moreover, the Inter-Borrower Agreement (as discussed below) between, among others, ML Manager and the Loan LLCs, provides specific reserves, expenses, and payments that must be made before distributions.

In its October 21, 2009 Memorandum Decision, the Court stated:

> "Paragraph U of the Confirmation Order permits the ML Manager to charge back to the non-opt-in participating investors [i.e., the current Pass-Through Investors] their proportionate share of all of its expenses, including but not limited to the exist financing. This Plan does impose a limitation that such charge back be fair, equitable and proportional, but with those limitation the ML Manager can exercise [its] business judgment whether to obtain financing to cover exit costs and operations expenses, and when to make the charge backs."

In other words, the Pass-Through Investors are to be treated the same as the Investors in the Loan LLCs. They are to be treated no better, or worse than the members of the Loan LLCs.

Thus the Plan, as interpreted by the Court, provides that before making any distributions, ML Manager has a duty to assess to all Investors, that includes all investors who are in the Loan LLCs, and all Pass-Through Investors who did not transfer their interests into a Loan LLC,[10] their share of all costs and expenses, including those costs

[10] Although ML Manager believes this includes the 401(k) Plan, ML Manager does not intend to take any position that is in violation of ERISA law or otherwise legally

and expenses associated with the Exit Financing and costs incurred in managing the Loans. The Costs must include the amounts paid or required to be paid under the Plan, including professional fees approved by the Bankruptcy Court, Exit Financing costs, the on-going costs of serving and collecting the Loans, operating costs of ML Manager, litigation costs with various parties involved in the Loan matters and costs, including specific costs, for a particular Loan, which are already allocated to the Loan LLCs under the Inter-Borrower Agreement between the ML Manager, the Loan LLCs and the Liquidating Trustee which was approved under the Plan and the other Investors under the Plan and orders of the Bankruptcy Court. The intent and objective is to allocate the Costs in a fair, equitable and non-discriminatory manner so that no Investor gets a "free ride" and each Investor pays his or her fair share, but nothing more.

The Inter-Borrower Agreement is one of the foundations for the Allocation Model. The Inter-Borrower Agreement was discussed in the Plan. Moreover, the basic terms of the Inter-Borrower Agreement were presented to the Court through testimony of witnesses during the confirmation hearing on May 18, 2009, and a copy of a draft inter-borrower agreement, that is materially similar to the final version, was distributed to various parties during the confirmation process and during discovery and depositions during this process. Finally, as noted above, paragraph H to Confirmation Order expressly authorized the execution of a inter-borrower agreement.

C. <u>The Basic Elements of the Allocation Model</u>

The Inter-Borrower Agreement provides for the various methods of allocation between the Liquidating Trust and the Investors and allocation among the Investors and must be consulted with respect to specific allocation issues. To implement the allocations as contemplated by the Inter-Borrower Agreement, it is imperative that once the Costs

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improper. As such, if a determination is made that the 401(k) Plan is not subject to some or all of the Costs, ML Manager will re-work the Allocation Model accordingly.

have been allocated among the Investors that sufficient moneys be withheld from any distributions to Investors to assure that there will be sufficient funds at what is defined in the Inter-Borrower Agreement as the "Final Settlement" date. The Final Settlement is the date when under the Inter-Borrower Agreement all Costs which have been incurred are paid and there has been a "practical realization" of the assets of the ML Loans and the assets of the Liquidating Trust. In other words, the Final Settlement is when there has been a final disposition of most or all of the ML Loans and the Liquidating Trust assets.

The Costs include the amounts paid or required to be paid under the Plan, including professional fees approved by the Bankruptcy Court, Exit Financing costs, the on-going costs of servicing and collecting the Loans, operating costs of ML Manager, litigation costs with various parties involved in the Loan matters and costs, including specific costs for a particular Loan, which are allocated to the Loan LLCs under the Inter-Borrower Agreement between the ML Manager, the Loan LLCs and the Liquidating Trustee which was approved under the Plan and the other Investors under the Plan and orders of the Bankruptcy Court.

A basic premise of the Allocation Model is that all Investors in loans where there is an adequate recovery pay the same proportionate share of the Costs, which necessarily includes a reasonable estimate to cover potential future expenses. This is described in the Allocation Model as the "Total Estimated Costs." However, if the Total Estimated Costs are less than estimated, which is the hope because the assumptions in the Model were all intended to be very conservative, there may be additional distributions possible at or before the Final Settlement or during a "True-Up" process.

As the Court will recall from the evidence presented during the Plan confirmation hearings and in briefing and argument last fall in connection with the Motion for Clarification filed by the Rev-Op Group, there is an issue of whether Pass-Through Investors in loans that resolve early will be required to hold more money in reserve than their Total Expected Costs, and if so, whether they would receive payments and interest from proceeds from loans that resolve later. Because the Allocation Model adopted by ML Manager is not requiring or contemplating that the Pass-Through Investors be assessed more than their share of the Total Expected Costs, the answer to this question is, No.

The Plan contemplates that the Exit Financing will be repaid as quickly as possible. Indeed, 70% of all money received by the Loan LLCs must be paid by the Loan LLCs to the Exit Financier (after a reserve is taken off the top for operating costs for ML Manager of up to 10% or a total of $5 million).[11] This means that more money will be paid to the Exit Financier from loans that are resolved earlier than loans that are paid later. To adjust for this, money from loans that are resolved later will be paid back to the Loan LLCs who paid the Exit Financing, plus interest. The interest paid to the Loan LLCs who paid off the Exit Financing is known as "Replacement Loan Interest." The Allocation Model that ML Manager has adopted provides both the Loan LLC members and Pass-Through Investors will be assessed their share of the Total Estimated Costs, but for the Loan LLCs, when an amount in excess of the Total Estimated Costs is taken under the 70% payment to the Exit Financier, that amount in excess of the Total Expect Costs is a "Replacement Loan" to be repaid with the "Replacement Loan Interest." Because the Pass-Through Investors are not initially assessed any more than their share of the Total Estimated Costs, they do not receive any Replacement Loan Interest. In other words, the Pass-Through Investors will receive money earlier than their counterparts in the Loan LLCs, but they will not receive the Replacement Loan Interest, which is at the same interest rates as is in the Exit Financing or 17.5%. As noted above, once the Total Estimated Costs are paid on a particular loan, the Investors in that Loan are no longer responsible for either the Exit

[11] The Pass-Through Investors also are not required contribute to the 10% reserve, nor do they receive any of the additional interest or Replacement Loan Interest on the reserve.

Loan Interest or the Replacement Loan Interest. They will have paid their fair share.

D. Detailed Allocation Steps

Key elements in the process include making an estimation of the: (i) total Costs which will be incurred, (ii) total recovery[12] from the sales of Loans and foreclosed assets and (iii) length of time which will be required to liquidate the assets ("Disposition Period") and arrive at a Final Settlement. To be conservative, where the total recovery of from the sale of a Loan and foreclosed assets is unknown, ML Manager has adjusted its estimated recovery amount in the Allocation Model by decreasing them 20% from current estimates if the assets have not yet sold. For the same reason, ML Manager has also increased in the Allocation Model its estimated operating costs going forward by 15% over their current best projections. This makes the Model extremely conservative and hopefully the final recovery will be substantially more than what is reflected in the Model.

With these principles, adjustments, and underlying premises, ML Manager has adopted the following allocation steps in its business judgment and as required by the Inter-Borrower Agreement for determining the "Sharing Ratio" among Investors for sharing Costs, for estimating the potential recovery from the sale of assets and estimating the Costs, and various re-allocations resulting from the inability of some Investors or the Liquidating Trustee to pay some or all of their allocated share of the Costs (the

[12] ML Manager and its professionals and consultants have spent considerable time in estimating the total potential recovery from sales of Loans and foreclosed assets. Significantly, however, this information is extremely confidential and proprietary. For example, ML Manager is in the process of negotiating sale prices with potential buyers of many parcels, and pursuing and negotiating deficiencies from borrowers and guarantors. It would be extremely damaging to these negotiations and processes to disclose the estimated recovery or any information about expected revenues. Nevertheless, it was essential to this Allocation Model to make such estimations. To eliminate the prejudice that would occur to ML Manager and ultimately the Investors from a disclosure of these recovery estimates, ML Manager has not included these numbers in this filing. ML Manager is prepared to disclose these estimates to the Court for an *in camera* inspection and to any investor who agrees to a Court ordered confidentiality agreement to prohibit the use or further disclosure of these numbers. Simultaneously with this filing, ML Manager is filing a Motion to set up a procedure to deal with this issue.

"Uncovered Costs") to get to the Total Estimated Costs for each Loan. The following is an outline of the general steps taken to determine the allocations.[13]

1. Determine Outstanding Loan Balances

Determine the outstanding principal balances for all Loans (each a "Loan" and collectively the "Loans") for which ML Manager is the Agent or which were held by an Investor the date that Mortgages Ltd. filed bankruptcy. The ratio of each Loan's outstanding principal balance to the total principal balance outstanding is the initial "Sharing Ratio" and the individual Sharing Ratio for each of the Investors in a loan is their percentage interest in the particular Loan.

2. Loan Recovery Analysis

Review each Loan and assign an estimated gross sale amount ("Recovery") to the Property securing the Loan or an REO Property and then deduct the estimated Selling Costs and Property Liens.[14] Then, determine by Property the projected pool of revenue available to make payment of Costs after the 20% adjustment if actual amounts are unknown (the "Adjusted Net Proceeds"). The analysis includes an estimate of the likely sales price of the property securing the Loans or the REO Property based upon the available information, including broker's opinions, as well as the potential Recovery from guarantors. The estimate needs to be very conservative since it is better to withhold too much money than too little money since the ML Manager is required to withhold sufficient funds from distributions to Investors to assure, to the extent possible based upon current available information, that sufficient funds are available on or before the Final Settlement date to pay all Costs. In determining the Adjusted Net Proceeds, until the factual data proves otherwise to a reasonable certainty, the Allocation Model assumes that

[13] Attached as Exhibit B is a summary of the detailed allocation steps.

[14] As noted above, the estimated Recovery and all estimates that would allow the determination of the estimated Recovery are only being disclosed for *in camera* inspection or subject to a Protective Order. This is because such information is confidential and would harm ML Manager's attempts to maximize the return from each of the ML Loans.

the Liquidating Trustee will have no Recoveries from the Non-Loan Assets and assumes that there will be no Loan LLC Recoveries on Loan LLC Causes of Action. The Adjusted Net Proceeds analysis will be revised if and to the extent of any actual such Recoveries.

3. <u>Recalculate the Sharing Ratio</u>

Once the Loan recovery analysis is done, the Sharing Ratio for each of the Loans where a positive Recovery is expected ("Positive Recovery") must be recalculated ("Revised Sharing Ratio") using in the denominator only the outstanding principal balances of the Loans where a Positive Recovery is expected. To the extent that the Revised Sharing Ratio causes one or more Loans to have a Recovery which is negative ("Negative Recovery") after deducting the allocation of Costs to a Loan, the same process must be undertaken for as many times as necessary to assure to the extent possible that all Costs will be covered by remaining Loans expected to have a Positive Recovery.

4. <u>Estimate the Disposition Period</u>

Once the Adjusted Net Proceeds has been calculated, the Allocation Model then estimates the timing of the various sales of Loans and/or foreclosed properties ("Disposition Period"). The Disposition Period will assist in determining when the Exit Financing and all of the fees payable under the Exit Financing Loan will be repaid. Since the Exit Financing is repaid by using 70% of the proceeds from the sales or recoveries under Loans, the 70% payment, to the extent that it exceeds the Costs allocated to such Loan, becomes a Loan by the members of the Loan LLC which made the Recovery and payment to the other Loans ("Replacement Loan") which will then bear interest at the same rate as the Exit Financing until finally repaid on or before the Final Settlement date. To the extent that any Permitted Reserve of up to 10% of the gross proceeds from a sale by a Loan LLC is withheld by ML Manager in arriving at Net Disposition Proceeds, or any ML Charges belonging to that Loan LLC that are used for Costs, those amounts must be added on to the amount of the Replacement Loan due to the Loan LLC which bears interest at the same rate as the Exit Financing. The Model estimates the Final Settlement date based upon the projected Disposition Period. Given the difficulty in trying to estimate the Disposition Period and the bankruptcies of borrowers and potential litigation, there are many risks. Accordingly, the Allocation Model is conservative on its estimates of when the properties or Loan Recoveries will occur since any delay in the projected schedule may increase the amount of interest, fees, and Costs incurred.

5. Estimate the Expected Costs

Based upon the estimate of the Disposition Period, the Allocation Model then estimates all of the Costs which are expected to be incurred through the Final Settlement, including, without limitation, the: (i) the total costs of the Exit Financing, including interest and fees, through payoff of the Exit Financing Loan, (ii) the total cost of the Replacement Loans and Permitted Reserve loans through payoff of such loans on or before the Final Settlement and (iii) all other costs and expenses which are expected to be paid[15] (collectively, the sum of which is called "Expected Costs").

6. Separate Expected Costs into General and Specific Costs

The Allocation Model then separates the Expected Costs into those which are general expenses ("General Costs") to be spread across all Loans and those which should be charged to a specific Loan because they were incurred for the benefit of a specific Loan rather than all Loans generally ("Specific Costs"). ML Manager has the discretion to allocate Servicing Costs as General Costs or Specific Costs based upon the level of servicing needs for a particular Loan.

7. Spread the Separated Costs

The Allocation Model next spreads the Specific Costs to the Loans for whose benefit the expenses were incurred and the spread the General Costs across all of the Loans. To the extent that the spreading of General Costs and Specific Costs causes a

[15] Future costs have been projected, and these projections have been increased 15%.

particular Loan to have a Negative Recovery rather than a Positive Recovery, the Negative Recovery amount of the Uncovered Costs must then be spread to the remaining Loans in the ratio of their Revised Sharing Ratios until all Negative Recovery amounts have been eliminated. This will result in a Total Estimated Costs for each Loan which needs to be maintained. The Total Estimated Costs for each Loan needs to be updated using the procedures set forth in this memorandum as new factual data, in the business judgment of the ML Manager, requires the Total Estimated Costs to be recalculated. Until the Total Estimated Costs for any Loan is fully funded, no distributions should be made to the holders of the Loan, and no Replacement Loan interest shall be accrued. If the Total Estimated Costs is fully funded with respect to a particular Loan but a recalculation with respect to that Loan shows that a higher Total Estimated Costs is required, then the next proceeds payable (i) to the Loan LLC in repayment of any Replacement Loan made by the Loan LLC should be used to fully fund the Loan LLC's share of the Total Estimated Costs before any further funds are distributed to the members of the Loan LLC, and (ii) to the other Investors shall be used to fully fund the other Investors share of the Total Estimated Costs before any further funds are distributed to the other Investors. Conversely, if a recalculation of a Total Estimated Costs shows that such amounts should be lower, then ML Manager, in its business judgment based upon the then current state of facts, may release some or all of the excess as a distribution to the Investors. For all Loans that are able to pay their full share of the General Costs and Uncovered Costs, the percentage of such amount is proportional over all Loans and is just over 3% of the principal balance of the Loan. Moreover, the spreading of the Specific Costs between Loan LLC members and Pass-Through Investors is also proportional, but one loan may have more Specific Costs than another loan.

8. <u>Determine Withholding from Distributions</u>

Based upon the Total Estimated Costs to be spread or allocated to the ML Loans based upon the Total Estimated Costs for each Loan, the Allocation Model determines for each Loan how much of the Total Estimated Costs the Loan holders are responsible for based on the Revised Sharing Ratio. Next, the Allocation Model determines with respect to the Loan LLCs, whether any Replacement Loan made by the Loan LLC to repay the Exit Financing or other Replacement Loans is greater than the share of the required Total Estimated Costs for which the Loan LLC is responsible. If such Replacement Loan amount is greater than the Loan LLC's share of the Total Estimated Costs then no further withholdings need be made from the Loan LLC's share of any Recovery on the Loan, unless the Total Estimated Costs has been or needs to be increased. If the Replacement Loan made is less than the Loan LLC's share of the Total Estimated Costs or if the Total Estimated Costs has been or needs to be increased, the Model then determines how much must be withheld from the 30% of Net Disposition Proceeds otherwise distributable to the Loan LLC to fund its share of the Total Estimated Costs for that Loan. The Model next determines whether the Adjusted Net Proceeds allocable to the Pass-Through Investors is fully sufficient to fully fund their share of the Total Estimated Costs for the Loan before any distributions are made to Pass-Through Investors in a Loan so as to ensure that all amounts owed by a Pass-Through Investor as its share of the Total Estimated Costs can be paid on or before the Final Settlement.

9. Repayment of Replacement Loans and Permitted Reserves prior to Final Settlement

Once sufficient Replacement Loans have been made to pay off principal, interest and any other current fees due on the Exit Financing, as subsequent Loans or foreclosed assets are sold, the Allocation Model assumes that 70% of the Net Disposition Proceeds from each additional disposition ("Current Disposition") are available to reduce, but not below the Total Estimated Costs for that Loan, the outstanding balance of the pool of Replacement Loans and Permitted Reserves, including the Replacement Loan being made by the current disposition. The 70% of Net Disposition Proceeds should be paid to all Replacement Loan lenders and Permitted Reserve Lenders, including the Current Disposition Loan lender, in the ratio of the amounts of their then outstanding principal and accrued interest which will partially reduce the outstanding Replacement Loans and Permitted Reserves prior to the Final Settlement date. Amounts repaid to a Replacement Loan lender should first be used to fully fund the then required Total Estimated Costs for its Loan prior to making any distribution to the holders of such Loan.

10. Final Settlement and True Up

Even though the Total Expected Costs and Adjusted Net Proceeds will be adjusted from time to time as information becomes available when actual Costs and Adjusted Net Proceeds become known by virtue of sales and Costs actually being incurred, on the Final Settlement,[16] the ML Manager shall perform a final true up of revenues and Costs and adjust any final distributions to the holders to make sure to the extent possible that each has paid his or her fair and equitable share of the Costs based upon actual Costs, Adjusted Net Proceeds, and other issues which may arise.

IV. APPLICATION OF THE ALLOCATION MODEL WITH RESPECT TO THE NEWMAN LOAN

The Newman Loan reflects a very simple application of the Allocation Model. The Newman Loan was paid in full by the borrower and there was no Loan LLC set up for the loan. This means that there does not need to be an estimate of the loan recovery, or an estimate of the sale date. There were very few loan specific costs with this loan. It was also one of the first loans to be resolved. Because there was no Loan LLC involved, the required 70% payment to the Exit Financier is not applicable. All that is necessary is to

[16] The concept of the Final Settlement includes the receipt of all payments, if any, from the Liquidating Trust or resolution of the Liquidating Trust's share of the Costs. On the other hand, there may be adjustments or true-ups at various times prior to the Final Settlement as to amounts that are distributed or allocated to the Investors based on further adjustments in the Allocation Model.

calculate the Total Expected Costs, which includes Exit Loan Interest and Costs,[17] General Costs and Uncovered Specific Costs and Covered Specific Costs. The Newman Loan, like all other Loans with a Positive Recovery, are expected to pay just over 3% of their principal balance for General and Uncovered Costs. Exhibit C sets forth the Total Expected Costs for the Newman Loan (assuming for now that the 401(k) Plan is excluded from the Allocation Model), and the net distribution to the Newman Loan Investors.

Pursuant to the Newman Loan Order, ML Manager has tendered and the undisputed portion of the distribution checks of approximately 80% of the amount of the Newman Loan pay-off to all of the Newman Loan Investors except Rosenfield. When the Allocation Model is approved, the difference between the amount already distributed and the amounts set forth in Exhibit C will be distributed, except for distributions to Rosenfield which will await the resolution of the offset and recoupment issues.

As noted in a previous footnote, the Agency Agreements that govern the relationship between ML Manager and the Newman Loan Investors (and all other Pass-Through Investors) provide that the Investors must "indemnify, protect, defend and hold Agent [ML Manager] harmless for, from and against all liabilities incurred by Agent in performing under the terms of this Agreement or otherwise arising, directly or indirectly, from any Loan or the Loan Documents, including all attorneys' fees, insurance premiums, expenses, costs, damages and expenses." (Agency Agreement, at ¶ 4(a)). Additionally, the Agency Agreements provide that if an Investor "breaches this [Agency] Agreement by failing to perform or by interfering with the Agent's ability to perform under this [Agency] Agreement, then [the Investor] shall pay any administrative fees, attorneys' fees, costs, closeout fees and any other fees or charges owed to Agent as compensation hereunder, along with any additional damages incurred by Agent, incidental or

[17] This includes all interest and other costs associated with the Exit Financing such as the $7.5 million Disposition Incentive Payment, but does not include the principal amount of the Exit Financing that was spent to pay General Costs.

consequential."

In this case, Morley Rosenfield, as Trustee of the Morley Rosenfield, M.D. P.C. Restated Profit Sharing Plan ("Rosenfield") has repeatedly litigated and contested ML Manager's actions and authority under the Agency Agreements. Rosenfield is a member of the so-called Rev-Op Group and has been a frequent litigant and objector to ML Manager's efforts. This litigation and these objections have caused ML Manager to incur substantial fees and costs, have delayed and hindered ML Manager's ability to resolve or dispose of ML Loan assets thereby increasing interest and other expenses, and otherwise causing damages or costs. ML Manager believes, in the exercise of its business judgment, that the amount of fees, costs and damages owed by Rosenfield, already exceeds or will exceed the amount of their expected distribution from the Newman Loan.[18] ML Manager does not believe that all Investors should bear the fees, costs and damages occasioned by a small group of litigious investors such as Rosenfield and so ML Manager intends to offset or seek recoupment or payment of amounts owing under the Agency Agreements from distributions. Once applied, such offsets will be applied to the appropriate Costs in the Allocation Model and reduce the Total Expected Costs for all loans.

Although ML Manager believes that its offset and recoupment claims against certain Investors is supported by the applicable agreements and warranted by the facts, ML Manager also recognizes that there is or may be disputes about these offsets, recoupments or payment claims. To be fair to all parties, including the Investors who are the subject of the offset claims and the Investors who are being damaged by the actions underlying the offset claims, ML Manager has decided that until there is a final resolution

[18] For example, this Court granted a Final Declaratory Judgment against Rosenfield and the other Rev-Op Group Investors. Pending before the Court is a fee application where ML Manager is seeking over $92,000 jointly and severally against the Rev-Op Group, including Rosenfield. Moreover, there are substantial other fees and costs that ML Manager has incurred as a result of the Rev-Op Group's continual objections that are subject to the indemnity, offset, and recoupment provisions identified above.

or agreement on these issues, it will deposit the amounts that are subject to the offset and recoupment claims into an interest bearing escrow with a third party. As such, the distributions for Rosenfield have been deposited into an interest bearing escrow account maintained by the escrow agent, Canyon State Servicing Co. LLC.

V. ADDITIONAL EXPLANATION OF COSTS AND EXPENSES INCURRED

The Costs that have been incurred and have been accounted for in the Allocation Model must be placed into context of the effort taken, progress and results that have been achieved, and complexities of the issues needing resolution. First, it must be noted that the Administrative Costs incurred during the 11 months of the bankruptcy were several multiples of the costs that have been incurred in the 15 months since confirmation and the number of loans foreclosed on, resolved or otherwise moved forward is many times greater. Indeed, the millstone of the Administrative Costs from the bankruptcy, and the tremendous cost to raise the money to pay those Administrative Costs based on a portfolio of loans, all of which were in default, has created a steep mountain to climb. In addition, as the Court is well aware, there are many different factions or parties involved in this matter and substantial dollars at stake. As such, there have been some significant issues to overcome, agreements to work out and many disputes that have been resolved or are in the course resolution.

One of the significant issues that has now been resolved since confirmation is the resolution of all of the professional fee applications from the bankruptcy proceedings. The shear size of the Administrative Claims that had to be paid in order to emerge from bankruptcy has always been the millstone around the neck of this case. There were two DIP loans owed to Stratera that had to be repaid that totaled, $5,809,213. In addition, there were substantial professional fees that had to be paid, and some of the operating costs for ML Servicing.

In the confirmation process, using the best evidence that was then available based on the Debtor's disclosures and Monthly Operating Statements and the Debtor's then expressed-current estimate of fee exposure, the evidence presented to the Court was that there was approximately $7 million in outstanding unpaid professional fee claims. Following confirmation, however, over $13 million in fee applications were filed. This consisted of over 20 separate fee applications. Three small fee applications were litigated, but the rest were resolved through either mediation or negotiation. Through all of this effort, the total amount of fees finally awarded was reduced to about $9 million. Although there was a significant savings in achieved through this process, it also involved substantial time and effort.

In addition to the resolution of the Administrative Claims incurred during the bankruptcy, the administration or disposition of the ML Loan assets is extremely complex, convoluted and time consuming. There were a total of 59 ML Loans. Of this amount, only five were performing. The rest were in default. Prior to confirmation, despite the millions in fees incurred by the Debtor, only few loans were foreclosed on or otherwise resolved. Since confirmation, there have been 26 foreclosure sales. Settlement or resolution has also been reached with several borrowers. One of the most significant settlements was with the Grace Entities. The Grace Entities was one of the primary litigants with the Debtor before and during the bankruptcy, and had asserted one of the largest proofs of claim. After a lengthy settlement and documentation process, a settlement agreement with the Grace Entities was finally approved and has now been consummated. Four of the six properties owned by the Grace Entities has now been foreclosed on and are being marketed for sale. ML Manager expects to file a motion for a sale of the Osborne III property shortly.

Another substantial borrower matter has been the Centerpoint project and the Tempe Land Company ("TLC") Loan. As the Court knows, TLC was in its own bankruptcy before Judge Marlar. Following confirmation in this case, the TLC bankruptcy was converted to a Chapter 7. Through litigation, the stay was lifted and ML Manager conducted a trustee's sale of the property. There are significant collateral issues in that matter such as the ownership of two adjoining lots, and TLC's rights to claims against ML Manager. In addition, Centerpoint Holdings, LLC has recently asserted first right of refusal rights. All of these matters have complicated and delayed matters, but ML Manager has generally prevailed and is now in the process of evaluating offers on the property and will shortly be filing a motion to approve a sale of assets.

ML Manager has completed the final sale and disposition of the Chateaux on Central property. In addition, through lengthy and involved negotiations, ML Manager also reached a settlement with all of the mechanic lien holders for less than a third of the gross amount of the liens that had been filed.

ML Manager is actively marketing the remaining properties. ML Manager has obtained broker opinions of value on many pieces of property, conducted detailed inspections and analysis of others, and listed the various properties with different brokers for sale.

ML Manager has been involved in substantial litigation. It is defending, through title insurance counsel, multi-million dollar mechanic lien claims on five separate projects. Generally, these matters are moving toward resolution but they have, at times, complicated disposition of the properties. ML Manager has continued to defend claims against individual investors that have been brought or threatened by borrowers, including the successful defense in the District Court of an appeal by PDG/Los Arcos arising out of the dismissal of the claims against the Investors by this Court. The borrower has appealed that decision to the Ninth Circuit, where the briefing for that appeal is now proceeding.

ML Manager has brought many separate actions against guarantors, and that litigation is pending in many different courts. In addition, ML Manager is litigating with borrowers in at least seven separate borrower bankruptcies.

ML Manager has defended claims brought by some investors in state court against other groups of investors, and has assisted in helping other Investors and investor groups in prosecuting claims against various third party defendants. ML Manager negotiated tolling agreements with various third parties to preserve claims that may belong to the MP Funds.

ML Manager has spent hundreds of hours in dealing with title insurance issues including the tender of issues related to claims by mechanic lien holders against the various trust properties, trustee sale guarantee reports, insurance following trustee's sales, closing issues related to the disposition of properties and many other matters.

ML Manager has also dealt with many Investor Disputes. Of the approximately 1800 Investors in Mortgages Ltd., only a few have been active in opposing ML Manager's efforts, however, these few have been very active. These include the eighteen members of the Rev-Op Group, Sternberg, Furst, members of the Oxford Group, and the Guillorys. These Investors generally have fought to reduce their personal exposure to costs and expenses, seeking to shift those costs to other Investors, and/or seek more control or influence over the disposition of the properties at issue. This has resulted in substantial disputes and litigation over various issues such as the agency agreements, the business judgment of ML Manager in its decisions and its general method of operation. These disputes have, at times, substantially hindered and delayed ML Manager's ability to market and dispose of property and attend to the affairs of managing the various loans. ML Manager has incurred significant costs in addressing these disputes and expenses are on-going as there are five pending appeals appealing from nine separate Orders. There has also been disputes with the 401(k) Plan, and other entities.

During the time that ML Manager has been attending to all of these issues, it has done so with very little resources. Most of the money from the Exit Financing was used to pay the professional fees and DIP loans incurred during bankruptcy. It has been alleged since before the beginning of the year that ML Manager did not have money to continue. Although finances have been extremely tight, and ML Manager has had to spend considerable time and effort in dealing with the Exit Financing, negotiating various terms and arrangements, and doing everything it can to keep everything afloat, it has been able to do so. This is large part thanks to the literally hundreds of hours that the ML Board members and others have essentially volunteered to accomplish these actions. It is no small feat that ML Manager has moved matters to the current stage and that allocation of money for distributions is even a topic of discussion. Moreover, several of ML Manager's professionals, including Fennemore Craig, have deferred payment of substantial amounts of their fees, interest free, to facilitate the cash flow needs of ML Manager.

The bottom line is that ML Manager has moved the administration of the ML Loans forward and final resolution or disposition of the ML Loans and related assets. One step at a time, progress is being made. Although reasonable minds could differ on many if not most of the countless decisions that have been and must be made, there is little serious room for debate as to whether ML Manager has been diligent in efforts and working to make sound decisions using its business judgment.

VI. <u>CONCLUSION</u>

The Court should approve the Allocation Model, determine that it is generally applicable to all Investors, and approve the amount of the net distribution and Total Cost Estimate to the Newman Loan Investors, including the escrowing of the distribution amount for Rosenfield until all offset, recoupment and payment issues are resolved.

DATED: September 1, 2010

FENNEMORE CRAIG, P.C.

By *Keith L. Hendricks* *Keith L. Hendricks* (012750)
Cathy L. Reece
Keith L. Hendricks
Attorneys for ML Manager LLC

COPY of the foregoing e-mailed and mailed this
1st day of September, 2010 to the following:

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/s/ *Gidget Kelsey-Bacon*

EXHIBIT
A

EXHIBIT A

NEWMAN LOAN

LOAN 7987S2 Gross Loan Recovery For Distribution: $222,236

		Percentage of Loan Amount	**Net Distribution at Approx. 80%**
1.	Morley Rosenfield, M.D., P.C., Restated Profit Sharing Plan*	50.880%	$ *
2.	Tommy D. Crimmins or Judith Crimmins Family Revocable Trust	13.965%	$24,565.09
3.	Francis P. Surdakowski and Linda M. Surdakowski Trust	35.155%	$61,839.29

** Check for Rosenfield has been placed in escrow pending determination of indemnity claim against the investor and other offsets or recoupments.*

2348215

EXHIBIT
B

EXHIBIT B

SUMMARY NARRATIVE DESCRIPTION OF DISTRIBUTION ALLOCATION MODEL

Step 1: Determine Outstanding Loan Balance on the date of the bankruptcy and Initial Sharing Ratio of the particular loan as compared to the total of all loans on the date of bankruptcy.

Step 2: Estimate Gross Loan Recovery for each loan and Adjusted Net Sales Proceeds for estimated selling costs and property liens and to be conservative also adjust for a 20% market uncertainty.

Step 3: Recalculate the Sharing Ratio and then adjust to account for any loans with a Negative Recovery.

Step 4: Estimate the Disposition Period so all costs required to be paid beginning to end are covered.

Step 5: Estimate the Expected Costs to be incurred to the very end plus a 15% cushion for General Costs.

Step 6: Separate Expected Costs into General Costs to be spread over all loans and Specific Loan Costs to be paid by only that loan.

Step 7: Spread the Separated Costs so that to the extent some costs can't be paid by a loan those Uncovered Costs will be spread across all other loans.

Step 8: Determine withholding from Distributions of Total Expected Costs for each loan.

Step 9: Repayment of Permitted Reserve & Replacement Loans to be funded as part of Total Expected Costs.

Step 10: Final Settlement and True Up - Total Expected Costs and Adjusted Net Proceeds will be adjusted from time to time as information becomes available and once all dispositions and costs are final there will be a Final Settlement and True Up.

EXHIBIT
C

EXHIBIT C

ALLOCATION MODEL APPLIED TO NEWMAN LOAN

Loan No. 7987S2 **The Newman Loan** **Principal $222,351**

Step 1		Step2		Step 3	Step 4	Step 5	Step 6			Step 7			Step 8	Step 9	Step 10
Determine Outstanding Loan Balance	Determine Initial Sharing Ratio	Gross Loan Recovery	Adjusted Net Sales Proceeds	Revised Sharing Ratio	Disposition Date	Total Expected Costs	Exit Loan Interest & Costs	General Costs	Covered Specific Costs	Net Sales Proceeds Available for Distribution	Net Sales Proceeds Available for Replacement Loan Interest	Replacement Loans Interest Income	Determine Withholding	Future True Up	Projected Payout Based on Model Assumption
$222,351	0.0241	$222,236	$222,236	0.04122	6/14/2010	$12,077	$4,951	$6,973	$153	$210,159	$0.00	$17	$0.00	$1,642	$211,784