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21 **Attorneys for Official Investors Committee**

22 **IN THE UNITED STATES BANKRUPTCY COURT**  
23 **FOR THE DISTRICT OF ARIZONA**

24 In re:  
25  
26 **MORTGAGES LTD.**, an Arizona  
27 corporation,  
28  
Debtor.

In Proceedings Under Chapter 11

Case No. 2:08-bk-07465-RJH

**JOINT OBJECTION TO EXCLUSIVITY  
AND JOINT CROSS MOTION TO LIMIT  
EXCLUSIVITY**

**Date: September 29, 2008**

**Time: 9:30 a.m.**

Radical Bunny, LLC ("RBLLC") and the Official Investors Committee ("Investors") (collectively the "Constituents") hereby submit their Joint Objection ("Objection") to the Debtor's Motion to Extend Exclusivity To File Chapter 11 Plan (the

1 “Motion”) and their Joint Cross Motion to Limit Exclusivity (the “Joint Motion”) to allow  
2 the filing of their proposed plan of reorganization, as detailed below. The  
3 Constituents contend that the Debtor has not demonstrated “cause” to extend the  
4 exclusive period in which to file a plan and that based upon the facts and  
5 circumstances of this case, “cause” exists to limit the exclusivity so that the  
6 Constituents may submit their own competing plan of reorganization.  
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8 Simply stated, the Constituents want the opportunity to file a competing plan  
9 that would fair and equitably resolve the case to their satisfaction in a prompt manner  
10 so as to maximize the recovery for all Constituents, rather than let the Debtor  
11 continue to hold hostage the creditors and investors to their own exclusive viewpoint.  
12 The Constituents are prepared to file a plan and disclosure statement by November  
13 1, 2008. Such a timetable will not delay the Debtor but will permit the Debtor to  
14 proceed with its own plan on a parallel basis. Since the Debtor can not likely confirm  
15 a plan without the Constituents’ support, allowing the Constituents to file their own  
16 competing plan will allow a confirmable plan to proceed while keeping open the hope  
17 of a negotiated consensual plan between all the parties.

### 18 **FACTUAL BACKGROUND**

19 Prior to these bankruptcy proceedings, Mortgages Ltd (“ML”) was in the  
20 business of providing lending to various borrowers that typically were not in a position  
21 to obtain financing through conventional lenders. ML was operated by Scott Coles  
22 (“Coles”), who was the President, CEO, sole board member and sole shareholder.  
23 During the operation of ML, Coles was driving force in creating new lending  
24 opportunities for ML borrowers and developing the means for ML to obtain funds from  
25 investors and other sources to fund ML loans to borrowers. The loans were structured  
26 for each borrower depending upon the type of project and the needs of the respective  
27 borrower. ML obtained the funds for its loans to borrowers from three primary  
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1 sources:(1) Pass-through investors that provided funds to ML for the purchase of  
2 interests in Notes; (2) Investors that provided funds to MP Funds that then provided  
3 funds to ML for the purchase of interests in Notes; and (3) Funds were borrowed from  
4 RBLLC, which were in turn used by ML to fund loans to borrowers and for operations.  
5 Through these three sources that Coles cultivated, he was able to bring in significant  
6 sums into ML for funding of loans and the sale of the Notes, which as of the date of  
7 the petition totaled about \$925 million in Notes and Deeds of Trust.

8 On June 2, 2008, Mr. Coles took his life, leaving ML adrift without its  
9 charismatic leader.

10 A new board of directors and management team were quickly assembled in an  
11 effort to stem the hemorrhaging of the company. Not surprisingly, the newly  
12 appointed team was unable to fill Coles' shoes and address the onslaught of defaults  
13 on loan payments, claims by borrowers and cash flow shortages. Shortly thereafter,  
14 an involuntary petition was filed by several borrowers of ML on June 20, 2008. An  
15 order for relief was then entered on June 24, 2008, converting this proceeding to a  
16 Chapter 11.

17 The assets of ML upon the filing of the bankruptcy consisted of ML's undivided  
18 fractional interests in various Notes of about \$171 million, several REO properties  
19 and its right to receive servicing fees, etc. Most of these assets constitute the  
20 collateral of RBLLC. ML does not own the Investor's undivided fractional interests in  
21 the Notes of about \$754 million and is merely the servicing agent or manager of the  
22 MP Funds. Based upon the financial records of ML, the amount owed to RBLLC of  
23 about \$197 million exceeds the amount of value in the ML undivided fractional  
24 interests in the Notes of about \$171 million. Accordingly, ML does not hold any  
25 equity in any borrower loans and does not have a financial stake in the outcome of  
26 the loan, other than any servicing fees, loan fees and expenses it can collect.  
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1           After its entry into these proceedings, ML has continued to struggle. Early  
2 litigation focused upon the questionable nature of the formation of the new  
3 management team and legal counsel, which eventually resulted in the resignation of  
4 the interim CEO and the denial of approval of its regular counsel to act as its general  
5 bankruptcy counsel. Efforts were then directed to locate new attorneys to represent  
6 ML and to engage another new CEO to fill the void created by Coles' death. New  
7 counsel has been retained and appointed and an individual was hired as a  
8 replacement CEO at ML (the "New Professionals"). Subsequent to the installation of  
9 the New Professionals, several issues have been able to be resolved with approval of  
10 all parties; however, there remains a significant disconnect between the New  
11 Professionals at ML and the other constituents in this case.

12           For example, the New Professionals have caused ML to file a number of  
13 proposed settlements with borrowers of ML, most notably Tempe Land Company,  
14 University & Ash entities, Grace entities and Rightpath entities. These 4 loans alone  
15 total over \$405 million and make up a significant portion of the Investors Notes and  
16 Radical Bunny's collateral. Despite the fact that RBLLC and/or the Investors  
17 constitute the entire economic base for every loan of ML to a borrower and bear the  
18 risk of any adjustment to those loans, the New Professionals did not include RBLLC  
19 and/or the Investors in the negotiations with the 4 large borrowers prior to entering  
20 into the settlement, and in some cases even after hearing vehement objection from  
21 Radical Bunny and the Investor Committee, the Debtor proceeded with filing motions  
22 for approval of the settlements anyway. On Friday September 26, 2008, the New  
23 Professionals filed several settlement motions which have been set for hearing on  
24 October 16, 2008. While the propriety of the terms of each respective proposed  
25 settlement will be addressed in other pleadings, a review of some of the basic terms  
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1 is instructive so that Court can understand the conflict that exists between the  
2 Constituents and the New Professionals of ML.

3  
4 In a nutshell, New Professionals negotiated settlements with these 4 borrowers  
5 to be released of the consequences of the Debtor's own alleged misconduct, to  
6 prevent the appointment of a trustee or conversion to a chapter 7 which would  
7 remove the Debtor from control and end their dream of a reorganized entity, and to  
8 gain allies in the case. Unfortunately as the terms of the settlements which were filed  
9 with the Court on Friday September 26 reveal, these settlements which bought  
10 temporary peace with the 4 borrowers were at the expense of the Investors and  
11 Radical Bunny.

12 Each settlement will need to be evaluated on its own but the pattern that  
13 emerges is that the proposed settlements negotiated by the New Professionals  
14 provide for release of all guarantees in all 4 settlements, significant principal reduction  
15 from \$133 million to \$95 million in 1 settlement, conversion of \$43 million of debt to  
16 equity in 1 settlement, significant reduction of principal from \$120 million to \$80  
17 million in 1 settlement, subordination of liens in all 4 settlements to significant new  
18 loans, removal and elimination of all monthly interest payments to investors in all 4  
19 settlements, significant deferral of return of principal to investors in all 4 settlements,  
20 release of liens on collateral without payment in 2 settlements, the consolidation of  
21 separate loans to separate borrowers into one loan (regardless of the different  
22 investors in the different loans) so as to substantively consolidate the assets and  
23 loans as to the borrower group, among other things. All of these terms directly  
24 impact RBLLC and the Investors and guarantee significant impairment of their  
25 interests. More importantly, these proposed settlements benefit the Debtor by  
26 releasing it of alleged lender liability lawsuits, allow it to stay in business and control  
27 as debtor in possession and gain allies against the Investors and Radical Bunny. This  
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1 is hardly the conduct of a Debtor in Possession and an agent that owes fiduciary  
2 duties to the Constituents. Given this atmosphere, the Constituents desire to file their  
3 own plan and propose a fair and equitable resolution of the issues that they as the  
4 major constituents of the case can support.

5 One of the concerns about allowing the exclusivity to be extended is the  
6 soaring administrative expenses being incurred by the bankruptcy estate. As of  
7 August, the Debtor's professional fees alone are over \$915,000<sup>1</sup> just for June, July  
8 and August and a look at the docket in this matter reveals that those amounts will  
9 increase exponentially with the upcoming contested issues and related discovery.  
10 Septembers fees will be available shortly and because of the DIP financing and other  
11 issues pursued in September they are likely to be equally as high. Extension of the  
12 exclusivity will only increase the cost and delay of this case to the detriment of the  
13 unsecured creditors, the Investors and Radical Bunny.

14 The New Professionals at ML have now requested that the Court extend the  
15 provisions under Section 1121 of the Bankruptcy Code to give it additional time to  
16 have an exclusive right to file a plan of reorganization until December 19, 2008 and  
17 the solicitation period to February 17, 2009. According to its budget submitted at the  
18 DIP hearing, the Debtor will have exhausted its \$5 million working capital line by the  
19 end of December and unless it can sell assets or generate fees, it will be out of  
20 money. The Debtor has not filed any of the required monthly operating reports so it is  
21 impossible to tell if Debtor has insufficient operating funds and continues to operate at  
22 a loss. The Constituents have joined together to request that the Court deny the  
23 request by the New Professionals and to allow the real parties in interest in this case,  
24 the Constituents, to file a plan that will properly address their claims and interests.  
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28 <sup>1</sup> Jennings Strouss & Salmon incurred post petition fees and costs in July of \$169,039.54 and in August of  
\$337,195.39. Greenberg Traurig incurred post petition fees and costs in June and July of \$235,398.47 and in August of  
\$80,545.85. MCA incurred fees and costs of \$95,868.61 post petition for June and July.

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## LEGAL DISCUSSION

### I. THERE IS NO CAUSE BASED ON THE DEBTOR'S MOTION TO EXTEND EXCLUSIVITY

#### A. Statutory Provisions Governing Exclusivity

Section 1121 of the Bankruptcy Code grants the debtor the exclusive right to file a plan during the first 120 days after entry of the order for relief. 11 U.S.C. § 1121(b). That period is currently scheduled to expire on October 22, 2008. If ML files a plan within that time, it will be granted an additional 60 days (i.e., a total of 180 days) within which to obtain acceptance of the plan.

The bankruptcy court in its discretion may reduce or increase a debtor's period of exclusivity for "cause" pursuant to 11 U.S.C. § 1121(d)(1) which states:

Subject to paragraph (2) on request of a party in interest made within the respective periods specified in subsections (b) and (c) of this section and after notice and a hearing, the court may for cause reduce or increase the 120-day period or the 180-day period referred to in this section.

These provisions were intended to provide the court with flexibility in individual cases, *In re Lake in the Woods*, 10 B.R. 338, 344-45, (E.D. Mich. 1981), and to democratize the reorganization process. *In re Kun*, 15 B.R. 852, 853 (Bankr. D. Ariz. 1981).

The debtor-in-possession bears the burden of establishing "cause" for an extension of its exclusivity period. *See, e.g. In re Express One Int'l, Inc.*, 194 B.R. 98, 100 (Bankr. E.D. Tex.1996). *See also In re Dow Corning Corp.*, 208 B.R. 661, 662-663 (Bankr. E.D. Mich.1997)(discussing the balancing of burdens when a debtor seeks an extension and a committee sought to end exclusivity to file a competing plan).

The 9<sup>th</sup> Circuit B.A.P. has called into question several factors considered by some courts over the years, noting that the propositions that "complex cases require extended exclusivity, negotiations are facilitated by extended exclusivity,

1 and pending litigation warrants extended exclusivity,” have been “cogently  
2 debunked.” See In re Henry Mayo Newhall Memorial Hospital, 282 B.R. 444 (9<sup>th</sup>  
3 Cir. B.A.P. 2002). The Court said that the “key question” is whether extension of  
4 exclusivity “functioned to facilitate movement towards a fair and equitable  
5 resolution of the case, taking into account all the divergent interests involved.” Id. at  
6 453.

7  
8 **B. The Motion Does Not Establish Cause**

9 In the Motion, the New Professionals submit only one reason for extending  
10 exclusivity. They contend that ML is entitled to an extension of the exclusive period  
11 to file a plan on the basis that the bar date for claims has been extended (albeit just  
12 for investors). That is the only reason or cause set forth. There is not however any  
13 case law that provides that extending the claims bar date for one group of claims  
14 justifies extension of exclusivity. As the Court knows, it is not uncommon in chapter  
15 11 cases for claims to be filed right up until the conclusion of the disclosure  
16 statement hearing. Furthermore, based on conversations with the three attorneys  
17 who are filing proofs of claim for investors in large numbers, it is not difficult for the  
18 Debtor to figure out what the investors’ claims might be on an aggregate basis.  
19 Furthermore, treatment of those potential claims is also not difficult to propose.  
20 Debtors draft plans all the time without knowing all the claims. Under the  
21 circumstances in this case, this basis falls legally and factually short of ML’s burden  
22 to demonstrate cause for an extension under 11 U.S.C. § 1121(d).

23  
24 **II. CAUSE EXISTS TO ALLOW THE CONSTITUENTS TO FILE A**  
25 **COMPETING PLAN**

26 As noted above, 11U.S.C. § 1121(d) authorizes the Court to reduce or limit  
27 the exclusive period upon a showing of cause. As the 9<sup>th</sup> Circuit B.A.P. said in the  
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1 Henry Mayo case, the “key question” is whether extension of exclusivity “functioned  
2 to facilitate movement towards a fair and equitable resolution of the case, taking  
3 into account all the divergent interests involved.” Id. at 453.

4 In this case, a number of factors support a determination of cause to allow the  
5 Constituents to file a competing plan.

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- 7
- 8 • The fact that RBLLC and the Investors hold all economic interests in all  
9 borrower loans;
- 10 • The lack of any economic stake of ML in any borrower loans;
- 11 • The fact that the plan proponents (which hopefully will be the Constituents  
12 plus the Unsecured Creditors Committee) make up all classes in this  
13 reorganization entitled to vote;
- 14 • The fact that a joint plan by the Constituents will facilitate moving this  
15 case forward with a fair and equitable resolution of the case;
- 16 • The need to resolve the issues for investors and creditors without further  
17 delay or unnecessary additional administrative expense which will stretch  
18 into February 2009;
- 19 • The loss of Coles as the leader of ML and the lack of institutional  
20 knowledge and specific business experience of the New Professionals in  
21 the business operated by ML;
- 22 • The significant impairment of the interests of RBLLC and the Investors in  
23 the settlements with borrowers proposed by the New Professionals;
- 24 • The need to provide a mechanism whereby the real parties in interest in  
25 the loans can make the business decisions regarding their investments;
- 26 • The ability in a plan to settle some of the remaining issues in this case for  
27 the Investors, Radical Bunny and the unsecured creditors;
- 28

- 1           • The prospect of a competing plan may stimulate movement towards a  
2           consensual plan by all the parties in the case.

3           Since ML has no economic stake in the outcome of resolution of borrower  
4           loans and has no equity in this case, there is no basis to provide ML with an  
5           extension of the exclusive right to file a plan. The New Professionals are out  
6           negotiating with other people's money with no risk in the outcome and holding the  
7           investors and creditors hostage to their own desire to have a reorganized entity  
8           even if it is at the expense of the investors. They have no stake other than fees to  
9           be earned. The Court need only look to the proposed settlements to see that the  
10          New Professionals had no problem impairing RLLC collateral and the Investor  
11          interests while ensuring that they limited their own alleged lender liability exposure  
12          so that they can stay in business and earn extension and other loan fees.

13          Part of the reasoning for the inclusion of the provisions in Section 1121 in the  
14          Bankruptcy Code was to allow the debtor-in-possession the first opportunity to  
15          propose a reorganization plan based upon its institutional knowledge of the  
16          business and history of operations and experience in the industry. When Coles  
17          passed away and vacated the helm of ML, the company lost the heart of the  
18          operation. The New Professionals have neither the experience nor the institutional  
19          knowledge of ML's business operations to justify providing ML the exclusive right to  
20          file a plan of reorganization that will impact the Constituents and not ML.

21          Due to the lack of adequate time to respond to the Motion<sup>2</sup>, the Constituents  
22          believe there may be other factors that would support their joint request to allow  
23          them to file a competing plan. However, the fact that the Constituents have come  
24          together so quickly to make this request and to propose that they are prepared to  
25          file a joint plan by November 1, 2008 is, in and of itself, clear cause to allow them to  
26          file a joint plan by November 1, 2008 is, in and of itself, clear cause to allow them to

27 \_\_\_\_\_  
28 <sup>2</sup> The Motion was filed after 4:00 on Thursday, September 25, 2008 and the hearing is set for Monday, September 29,  
2008 at 9:30, effectively providing one business day to respond.

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submit a competing plan of reorganization that will address their respective claims and interests in this case. Combined with the loss of the leader of ML and the lack of economic stake of ML in the loans, this record provides ample basis for the granting of the relief sought.

**CONCLUSION**

For all of the reasons set forth above, the Constituents ask that this Court deny the extension of exclusivity and authorize the Constituents to file their own competing plan of reorganization.

DATED this 29th day of September, 2008.

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this 29th day of September, 2008, to: