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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

**BRIEF OF OFFICIAL COMMITTEE OF
INVESTORS IN SUPPORT OF PRICE
MOTION TO ABANDON**

Hearing: August 21, 2008
Time: 1:30 p.m.

The Official Committee of Investors (“Investors Committee”) hereby files its Brief in Support of the Price Motion to Abandon (“Price Motion”).

The Investors Committee supports the Price Motion and asserts that the Court should approve the Price Motion for several reasons. First, under Section 554 of the Bankruptcy Code, the interest payments owed to Mary Price are burdensome or of inconsequential value and benefit to the Debtor and should be abandoned to Mary Price. Second, under Section 541(d) of the Bankruptcy Code, the Debtor does not have legal or equitable title to the fractional interests in the Notes and Deeds of Trust which are owned by the Investors. Third, Article 9 of the Uniform Commercial Code does not apply because of Section 541(d) of the Bankruptcy Code and because the Investors purchased the Notes rather than taking a security interest in them. Fourth, even assuming Article 9

1 of the Uniform Commercial Code applies, under A.R.S. §§ 47-9308 and 47-9309, the sale
2 of the Notes was automatically perfected upon attachment without the need for perfection
3 through possession under A.R.S. § 47-9313. On any one of these bases, the Court should
4 approve the payment of interest and principal to Mary Price as requested.

5 **FACTUAL BACKGROUND**

6 As used in this Brief, the term “Investor” refers to both the direct pass through
7 investors who purchased undivided fractional interests in Notes sold to them by the
8 Debtor and to investors who own a membership interest in a limited liability company that
9 purchased undivided fractional interests in Notes sold to the LLC by the Debtor. In the
10 pass-through situation, at the time of the sale the Note was indorsed to the person (an
11 individual or retirement plan or company) in an undivided fractional interest and in the
12 second situation at the time of the sale the Note was indorsed to the name of the limited
13 liability company in an undivided fractional interest. There are about 10 limited liability
14 companies which hold mortgage interests in pools for investors and each one has a name,
15 such as MP 122030 LLC.

16 Mary Price purchased a membership interest in MP 122030 LLC, which is
17 commonly referred to as “MP 11” because it is the 11th first deed of trust pool established
18 by the Debtor. She paid \$450,000 as reflected by her check on February 1, 2007. In
19 exchange she received a 0.48% interest in the limited liability company known commonly
20 as MP 11.

21 MP 11 owns undivided fractional interests in about 43 loans originated by Debtor
22 and sold to MP 11. MP 11 from time to time purchased undivided fractional interests in
23 Notes sold by Debtor. MP 11 at this time has about \$90 million worth of undivided
24 fractional interests in Notes and Deeds of Trusts. Each time MP 11 purchased an interest
25 in a Note, the Debtor would indorse the Note to MP 11 in its undivided fractional interest
26 and also execute and record an assignment of beneficial interest and other documents. The

1 purchases were reflected at the time of the purchase and sale on the Debtor's book and
2 records. The Notes and the Indorsements and the Assignments of Beneficial Interests
3 showing MP 11's undivided fractional interest will be provided by the Debtor to the
4 parties. Pursuant to an agency agreement and subscription agreement which will be
5 provided by the Debtor to the parties, MP 11 authorized Debtor to purchase and hold the
6 original Notes and to service the payments received from borrowers.

7 Pre-petition, the normal business practice was for the Debtor to deposit the
8 borrower payments into the collection trust account at Irwin Union and to pass through or
9 forward the payments to the Investors directly or to the LLC's bank account which would
10 then, on a monthly basis, pass through the payments to the Investors. Post-petition the
11 borrower payments are being deposited into a separate account for each loan.

12 Since the filing of the bankruptcy, some of the borrowers have made interest
13 payments to Debtor. Since the filing of the bankruptcy about 14 borrowers have made
14 payments on loans in which MP 11 has undivided fractional interests. According to the
15 lists filed by the Debtor with the Court, the amount that would be payable to MP 11
16 appears to be about \$196,748.31. After payment of a management fee and a secured claim
17 to the VTL pool, the amount that would be payable through MP 11 to Mary Price would
18 be \$567.34. An additional borrower SOJAC I, LLC has interplead its payments of about
19 \$700,000 into the Bankruptcy Court and the Debtor will provide the additional amount
20 which would be payable to Mary Price from those payments. Pre-petition Mary Price
21 normally received about \$3,800 a month because all the borrowers in the 43 loans paid
22 their monthly interest. Post- petition only 14 borrowers have made their payments and that
23 number continues to shrink as borrowers find excuses not to pay.

24 Mary Price is currently in dire need of the payments. Mary Price is 89 years old,
25 has dementia and is recovering from breast cancer. She is in an assisted living facility in
26 California and depends on the monthly payments to pay for her support and care. If

1 payments are not commenced to Mary Price shortly she will be asked to leave the facility
2 and would not be able to receive the care that she needs.

3 **LEGAL ARGUMENT**

4 **1. The payments payable to Mary Price are burdensome to the Debtor or are**
5 **of inconsequential value and benefit to the Debtor and should be abandoned.**

6 Section 554 of the Bankruptcy Code provides that assets which are burdensome or
7 of inconsequential value and benefit to the Debtor may be abandoned from the estate of
8 the Debtor:

9 On request of a party in interest and after notice and a hearing, the court
10 may order the trustee to abandon any property of the estate that is
11 burdensome to the estate or that is of inconsequential value and benefit to
12 the estate.

13 11 U.S.C. § 554(b); *see, e.g., In re Bolden*, 327 B.R. 657, 661 (Bankr. C.D. Cal. 2005).
14 That is, before ordering abandonment, the bankruptcy court must find either: 1) the
15 property is burdensome to the estate; or 2) the property is both of inconsequential value
16 and inconsequential benefit to the estate.

17 The Bankruptcy Code, however, does not provide any guidance as to how to
18 determine whether such property is burdensome to the estate or both of inconsequential
19 value and benefit to the estate. Moreover, Section 554(b) of the Bankruptcy Code does
20 not specify to whom such property may be abandoned. Some courts have held that
21 property should be abandoned only to a holder of a possessory interest in it. *In re*
22 *Interpictures Inc.*, 217 F.3d 74, 76 (2d Cir. 2000). The rationale for this rule is that once
23 the debtor's property is abandoned in bankruptcy, the property should be treated as though
24 no bankruptcy proceedings had occurred and, therefore, revert to the party that held a pre-
25 petition interest in it. *In re Interpictures Inc.*, 217 F.3d at 76; *see Dewsnup v. Timm (In re*
26 *Dewsnup)*, 908 F.2d 588, 590 (10th Cir. 1990) ("Following abandonment, whoever had
the possessory right to the property at the filing of bankruptcy again reacquires that

1 right.”), *aff’d*, 502 U.S. 410, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992).

2 In this situation, it is proper for this Court to enter an order requiring the Debtor to
3 abandon the money to Mary Price. First, the Debtor has now withheld the payments since
4 June 23, 2008. Mary Price through MP 11 has a legal right to receive the money, which
5 belongs to her. That is, MP 11 directly, and Mary Price indirectly, has a possessory right
6 to the money; thus, as articulated in *In re Interpictures Inc.*, because Mary Price has this
7 possessory right to the money, this Court is permitted to order the Debtor to abandon the
8 money to Mary Price. Indeed, by the Debtor refusing to tender the money to Mary Price,
9 Mary Price continues to incur damages, and with each day, the amount of damages will
10 continue to accrue, which creates a burden on the Debtor and its estate. Such burden can
11 be eliminated if this Court orders the Debtor to abandon the property to Mary Price.

12 Moreover, the amount being withheld from Mary Price of \$567.34 is miniscule in
13 comparison to the amount of the principal of the investment of \$450,000, and is of
14 inconsequential value and benefit to the Debtor and its estate. By way of example, in
15 Mary Price’s case, at a minimum Mary Price will have either the indirect ownership right
16 to the undivided fractional interest through MP 11, or will have an unsecured claim
17 against the Debtor for a minimum of \$450,000. The payment of the interest in the amount
18 of \$567.34 to Mary Price now and each month hereafter can easily be offset or recouped
19 against such \$450,000 claim in the event she is later determined to have inappropriately
20 received any post-petition payments. In either event, as will be demonstrated below, it is
21 undeniable that Mary Price is entitled to receive the moneys and, therefore, such moneys
22 are of inconsequential value and benefit to the Debtor because the Debtor has no right to
23 receive or hold such amounts.

24 Further, such payment to Mary Price will not prejudice or harm any other creditor
25 of the Debtor. Even assuming Mary Price somehow is determined to be an unsecured
26 creditor, her claim would be in excess of \$450,000. Any interest payment could easily be

1 offset against her large principal claim. The Investors as a whole would have over \$730
2 million and their claims would dwarf all other creditors. As such they would be entitled
3 to the lion's share of the distributions from the estate either under a plan or under a
4 chapter 7 trustee's distributions. Continuing to hold Mary Price's payment is of no value
5 and benefit to the Debtor itself and of no consequence to the Debtor or the other creditors
6 of the estate. Accordingly, pursuant to Section 554(b) of the Bankruptcy Code, the money
7 should be abandoned and paid to Mary Price each month as it is received by the Debtor.

8 **2. Under Section 541(d) the Debtor is required to pay the collections on the**
9 **Notes to their rightful owners.**

10 The Investors own the Notes at issue, and the Notes therefore do not and cannot
11 form part of the Debtor's bankruptcy estate in the first place. A debtor's bankruptcy
12 estate is generally composed of "all legal or equitable interests of the debtor in property as
13 of the commencement of the case." 11 U.S.C. § 541(a)(1). The Bankruptcy Code,
14 however, specifically exempts a number of property interests from the debtor's estate,
15 including "any power that the debtor may exercise solely for the benefit of an entity other
16 than the debtor." 11 U.S.C. § 541(b)(1). "To the extent that the legal or equitable interest
17 of the debtor in property is limited in the debtor's hands, it is equally limited as property
18 of the estate." *In re Squyres*, 172 B.R. 592, 594 (Bankr. C.D. Ill. 1994) (discussing
19 property a debtor holds in an express or constructive trust for the benefit of a third party).
20 Section 541(b)(1) thus serves to exclude property that the debtor holds in trust for others.
21 *See, e.g., Ryan v. Sullivan, Hill, Lewin, Rez, Engel and LaBazzo*, 316 B.R. 101 (D. Conn.
22 2004); *In re Greenfield Direct Response, Inc.*, 171 B.R. 848, 855-58 (Bankr. N.D. Ill.
23 1994) (finding that because the debtor acted as an agent or broker, under an express
24 agency agreement, in collecting monies for its customers and passing the payments
25 through to them, such monies were held in trust for the customers and did not fall within
26 the debtor's bankruptcy estate). In short, property does not automatically become a part

1 of a debtor's bankruptcy estate simply because the debtor may have some possession or
2 control over the property.

3 Moreover, "[p]roperty in which the debtor holds, as of the commencement of the
4 case, only legal title and not an equitable interest, such as a mortgage secured by real
5 property, or an interest in such a mortgage, sold by the debtor but as to which the debtor
6 retains legal title to service or supervise the servicing of such mortgage or interest,
7 becomes property of the estate under subsection (a)(1) or (2) of this section only to the
8 extent of the debtor's legal title to such property, but not to the extent of any equitable
9 interest in such property that the debtor does not hold." 11 U.S.C. § 541(d). In adopting
10 Section 541(d) of the Bankruptcy Code, Congress specifically intended to promote the
11 secondary mortgage market by protecting participation interests in loans from challenge in
12 bankruptcy and to exempt secondary mortgage market transactions from compliance with
13 state recording statutes and Article 9 of the Uniform Commercial Code. See the
14 Legislative history at S. Rep. No. 989, 95th Cong., 2d Sess.83-84 (1978); 124 Cong. Rec.
15 H 11,096 (Sept. 28, 1978) ("The seller of mortgages in the secondary mortgage market
16 will often retain the original mortgage notes and related documents and the seller will not
17 endorse the notes to reflect the sale to the purchaser. Similarly, the purchaser will often
18 not record the purchaser's ownership interest of the mortgages or interests in mortgages
19 under State recording statutes. These facts are irrelevant and the seller's retention of the
20 mortgage documents and the purchaser's decision not to record do not change the
21 trustee's obligation to turn the mortgages or interests in mortgages over to the
22 purchaser.").

23 In the case *In re Mortgage Lenders Network, USA, Inc.*, 380 B.R. 131, 133 (Bankr.
24 D. Del. 2007), the debtor engaged in the origination and purchasing of mortgage loans.
25 The debtor had "accumulated pools of mortgage loans and sold them to three trusts." *Id.*
26 The debtor "also entered into contracts with each member of the Trusts to be the mortgage

1 servicer for the Trusts.” *Id.* The bankruptcy court noted that the debtor, for a period of
2 eight years, had serviced the loans for the Trusts in a manner that recognized the Trusts,
3 and not the debtor, as the equitable owners of the mortgages. *Id.* at 137. The court held
4 that “Congress enacted § 541(d) to apply to this very type of case – i.e., where a mortgage
5 servicer in the secondary mortgage market holds legal title to property that it is servicing
6 on behalf of a purchaser of that property.” *Id.* at 138. Consequently, the court applied
7 section 541(d) in ruling that the debtor held “only bare legal title” in the subject
8 properties, and that the Trusts owned the “equitable interest.”

9 The case discussed above demonstrates that Section 541(d) applies in this case, and
10 is dispositive of the issue before the Court. As did the participants in *Mortgage Lenders*
11 *Network*, the Investors in this case purchased from the Debtor undivided participation
12 interests in mortgage loans. The Investors also entered into agency agreements that
13 provided the Debtor would retain the underlying loan documents and Notes, service them
14 on behalf of the Investors, and pass-through to the Investors their respective percentage of
15 any monies collected as interest payments or otherwise. Although the Debtor had
16 physical possession of the Notes, it did not own the Notes or underlying loans, which it
17 had sold to the Investors for fair market value.¹ The Debtor does not even have legal title
18 of the Notes, but even if it did have bare legal title, it is holding in trust and for the benefit
19 of the equitable owners, the Investors. Pursuant to Section 541(d), the Investors are
20 entitled to receive their percentage interests in the loans and Notes, which are not part of
21 the Debtor’s bankruptcy estate, and are not subject to the claims of the Debtor’s other
22 creditors.

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25 ¹ The Investors do not dispute that the Debtor retained fractional ownership interests in
26 some of the Notes, and that such percentage of the Notes may form part of the Debtor’s
bankruptcy estate.

1 **3. Article 9 of the Uniform Commercial Code does not apply in this situation.**

2 The Objectors have argued that the Investors failed to perfect their security
3 interests in the Notes under Article 9 of the Uniform Commercial Code because the
4 Investors do not have actual physical possession of the Notes. As set forth above,
5 however, Section 541(d) exempts the Notes from both the Debtor's bankruptcy estate and
6 Article 9. In addition, Article 9 does not apply to the sale of a note secured by an interest
7 in real property, but only to notes pledged as security to another party. *See In re After Six,*
8 *Inc.*, 177 B.R. 219, 227-28 (Bankr. E.D. Pa. 1995). The Objectors' argument relies on a
9 mischaracterization of the form and substance of the transactions between the Debtor and
10 the Investors. The Investors did not loan the Debtor money and agree to accept security
11 interests in the Notes in return. Rather, the Investors purchased from the Debtor outright
12 fractional ownership interests in the Notes. In other words, the Investors do not need to
13 obtain or perfect security interests in the Notes because the Investors own them. Article 9
14 therefore does not apply in this case.

15 **4. Assuming Article 9 does apply, the Investors interests in the Notes were**
16 **automatically perfected under Section 9-308 and 9-309.**

17 Even if Article 9 did apply, the Investors perfected their security interests in the
18 Notes under the automatic perfection provisions of A.R.S. § 47-9309, and need not rely on
19 A.R.S. § 47-9313 for perfection by possession. A.R.S. § 47-9308(A) provides that
20 “[e]xcept as otherwise provided in this section and § 47-9309, a security interest is
21 perfected if it has attached **and** all of the applicable requirements for perfection in §§ 47-
22 9310 through 47-9316 have been satisfied.” (emphasis added). A sale of a promissory
23 note, however, perfects immediately upon attachment without any further action. A.R.S.
24 § 47-9309(4); *see also* A.R.S. § 47-9310(B)(2) (stating the filing of a financing statement
25 is not necessary for security interests “perfected under § 47-9309 when it attaches.”).
26 Perfection of a promissory note secured by a lien or mortgage on real property also serves

1 to perfect a security interest in the lien or mortgage. A.R.S. § 47-9308(E); *see also* A.R.S.
2 § 47-9203(G) (providing the same regarding the attachment of a note secured by a lien).
3 In other words, in accord with the common law, a mortgage will follow the note it secures
4 upon sale of the note. *See* Comment 6 to U.C.C. 9-308. Objectors discussion of A.R.S.
5 § 47-9313 and possession requirements is irrelevant, as that provision merely sets forth an
6 alternative means of perfection of a security interest by obtaining possession. A.R.S.
7 § 47-9313(A) (stating “a secured party **may** perfect a security interest in tangible
8 negotiable documents, goods, instruments, money or tangible chattel paper by taking
9 possession of the collateral.”) (emphasis added). The Investors need not perfect their
10 interests in the Notes through possession because the sale of the Notes qualify for an
11 automatic perfection under A.R.S. § 47-9309(4). The Investors’ security interests in the
12 Notes thus would have been perfected upon attachment.

13 Under the UCC, a “security interest attaches to collateral when it becomes
14 enforceable against the debtor with respect to the collateral, unless an agreement expressly
15 postpones the time of attachment.” A.R.S. § 47-9203(A). Subsection B of the statute, in
16 turn, describes when a security interest “becomes enforceable against the debtor.” A
17 security interest will become enforceable if: (i) the purchaser pays value for the interest;
18 (ii) the seller has rights in the collateral or the power to transfer such rights; and (iii) the
19 seller authenticates a security agreement that provides a description of the collateral.
20 A.R.S. § 47-9203(B). In this case, the Investors paid fair market value for their
21 participation interests in the Notes,² the Debtor had rights in the Notes because it
22 originated and owned them prior to the sale to the Investors, and documented the
23 transaction by indorsing the Notes to the Investors and entering into agency agreements
24 for the servicing of the Notes. Consequently, the Investors’ security interests attached to

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26 ² Mary Price, for example, paid \$450,000 for her 0.48% interest in the MP 11 pool.

1 the Notes, which served to perfect the security interests in both the Notes and the Deeds of
2 Trust. *See* A.R.S. § 47-9309(4).

3 **CONCLUSION**

4 In sum, Mary Price is entitled to receive the payments made by borrowers and
5 under a number of different theories and arguments, the Court should grant the
6 abandonment and order payment to Mary Price each month as the payments of interest are
7 received.

8 As the Court is aware, Counsel has asked the other parties in this Bankruptcy to
9 stipulate to the payment of the interest as it is received from borrowers each month to
10 Mary Price and to the other Investors as their undivided fractional interest appears on the
11 records of the Debtor on loans in which they have an interest. This payment would be
12 without prejudice to the other parties to later ask the Court to offset such interest
13 payments against the Investors' principal investment. If such request is not agreed to by
14 the parties, then counsel requests that the Court order such payments to Mary Price and
15 the other Investors under either Section 554 or 541(d) of the Bankruptcy Code.

16
17 DATED: August 19, 2008

18 FENNEMORE CRAIG, P.C.

19
20 By /s/Cathy L. Reece
21 Cathy L. Reece
22 Attorneys for Official Committee of Investors

23 COPY of the foregoing emailed or mailed
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25 on the attached Service List.

26 /s/ Susan Stanczak-Ingram

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