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IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

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| In re<br><br>MORTGAGES LTD.,<br><br>Debtor. | **Chapter 11**<br><br>**Case No. 2:08-bk-07465-RJH**<br><br>**Motion of Mortgages Limited 401(k) Plan for Order Directing Release of Funds, and Memorandum in Support Thereof**<br><br>**Hearing Date: September 21, 2010**<br><br>**Hearing Time: 1:30 p.m.** |

Mortgages Limited 401(k) Plan ("401(k) Plan"), by and through undersigned counsel, hereby moves this Court for an Order declaring that certain funds currently held in escrow are the property of the 401(k) Plan and directing the immediate release of those funds to the 401(k) Plan. This Motion is supported by the following Memorandum.

## MEMORANDUM

### I. INTRODUCTION

The 401(k) Plan previously sought release of the funds at issue through its application for order to show cause (Dkt. 2776). The Liquidating Trustee and ML Manager raised procedural and substantive objections to the application to show cause (Dkts. 2818 and 2819). The procedural objections were resolved by the Court at a hearing

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on July 15, 2010. The substantive objection, based on a claimed interest of ML Manager in the escrowed funds allegedly arising out of Paragraph U of the Court's order confirming the Mortgage's Ltd. plan of reorganization and/or out of an alleged agency relationship between the 401(k) and ML Manager, is utterly without merit for two fundamental reasons, addressed in detail in Section III of this Memorandum:

1. Neither the confirmation order nor the plan of reorganization confers on ML Manager any interest in or right with respect to the impound funds. The Debtor's representatives repeatedly acknowledged as much to the 401(k) Plan's fiduciaries and beneficiaries in connection with the confirmation of the plan of reorganization and thereafter.

2. The interest claimed by ML Manager is categorically prohibited by ERISA. Indeed, if ML Manager held the rights it claims with respect to the escrowed funds, ML Manager, its directors, counsel and others involved in the exercise of those rights would become ERISA fiduciaries for the 401(k) Plan and would immediately be subject to the full panoply of remedies provided for by ERISA for the implementation of a prohibited transaction and other breaches of ERISA fiduciary duties.

## II. FACTUAL BACKGROUND

At issue here are impound accounts established in connection with the Ecco Loan and the Hurst Loan. The Promissory Notes, Deeds of Trust ("DOTs") and Servicing Agent Agreements ("SAAs") pertaining to the Loans are attached as Exhibits 1 through 6 to the Declaration of James Cordello, 401(k) Plan Trustee, ("Cordello Decl."). The 401(k) Plan's interest in these loans, together with its interest in the Bisontown, CDIG, GP Properties Carefree, 43rd and Olney, Downtown Community Builders and Vanderbilt Farms loans, are referred to herein as the "401(k) Portfolio."[1] The Ecco and Hurst Loans have been foreclosed, and title (100% for Ecco, 93.52% undivided interest for Hurst), has vested in the 401(k) Plan. Cordello Decl., Exs. 25-26.[2]

Ecco, Hurst and the other loans in the 401(k) Portfolio were made by the 401(k)

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[1] The Promissory Notes, Deeds of Trust and Servicing Agent Agreements for these loans are attached as Exhibits 7 through 24 to the Cordello Decl.

[2] With the exception of the CDIG loan, all of the loans in the 401(k) Portfolio have been foreclosed and title has vested in the 401(k) Plan. Cordello Decl. ¶ 45.

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Plan to the respective borrowers, as is evidenced by the identification of the 401(k) Plan as the holder of each Promissory Note and the beneficiary of each Deed of Trust.[3] Each Servicing Agent Agreement for the loan in the 401(k) Portfolio provides for automatic termination if the underlying property becomes vested in the 401(k) Plan, and provides that they are the "entire agreement and understanding" of the parties (¶¶ 3.b., 7.e., Cordello Decl. Exs. 3, 6, 9, 12, 15, 18, 21, and 24).[4]

ML Manager, the OIC and its counsel have repeatedly acknowledged that ML Manager has no agency relationship with the 401(k) Plan, nor any other right or interest with respect to the holdings in the 401(k) Portfolio. Examples include:

- The Disclosure Statement in support of the plan of reorganization states that, "the Loans in which the Mortgages Ltd., 401(k) Plan holds the ownership interest will not be transferred to Loan LLCs. Instead, the trustee(s) of the Mortgages Ltd. 401(k) Plan shall make their own decisions and decide who will service the Loans." Dkt. 1471 at 7, n.1.[5]
- In an e-mail exchange (Cordello Decl. Exs. 27 and 28), counsel for ML Manager, confirmed that (i) the three loans wholly owned by the 401(k) Plan, plus the Hurst and 43rd Ave. and Olney loans "can go their own way with no management or service involving the OIC Plan;" and (ii) as to the three other loans in the 401(k) Portfolio, the undivided interests held by others could be transferred to Loan LLCs, with the 401(k) Plan a "joint owner with the Loan LLC," with the right, together with the joint owner "to decide where to have the loan serviced and what to do to collect or workout the loan."
- At an August 28, 2009 meeting among representatives of ML Manager, the 401(k) Plan and others, ML Manager Board member Scott Summers stated that as a 401(k) Plan loan the GP Properties loan was not subject to the bankruptcy estate or chargeable with exit financing. None of the other ML Manager

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[3] Where the 401(k) Plan owns less than 100% of a loan (or the underlying property), that is the result of one or more assignments by the 401(k) Plan. An example of documentation pertaining to such an assignment is contained in Exhibit 29 to the Cordello Decl.

[4] In 2004, the 401(k) Plan and Mortgages, Ltd. executed a Master Agency Agreement, attached as Ex. 30 to the Cordello Decl. This document is similar to the Servicing Agent Agreements ("SAAs"), particularly with respect to the duties of Mortgages, Ltd. as agent. While the compensation provisions of this document (not found in the SAAs) render it void under ERISA as discussed in Section III below, with respect to the loans in the 401(k) Plan Portfolio, it was also superceded by the respective SAA (all of which post-date the Master Agency Agreement), which specifically state that they set forth the parties' entire agreement. Moreover, the Master Agency Agreement was terminated by the 401(k) Plan on June 3, 2009. Cordello Decl., ¶ 47. In addition, the Master Agency Agreement terminates by its terms upon foreclosure of the underlying property. Cordello Decl. Ex. 30, ¶ 3(b).

[5] Counsel for the OIC specifically called the 401(k) Plan Trustee's attention to this provision in connection with soliciting his support for the Plan of Reorganization. Cordello Decl., Ex. 27 (May 23, 2009 email from Ms. Reece).

representatives at the meeting objected to this statement. Cordello Decl., ¶ 43.

- In a letter dated November 3, 2009 concerning GP Properties, Mark Winkelman, the COO of ML Manager, stated that ML Manager is not the agent for the 401(k) plan." Cordello Decl., Ex. 32.

In addition, even with respect to loans as to which the 401(k) Plan holds less than 100%, ML Manager has specifically allowed the 401(k) Plan to "take the lead" with respect to management and administration, with the 401(k) Plan paying directly for services and other expenses. Cordello Decl. ¶ 46, Ex. 33.

The 401(k) Plan's plan documents provide that its trustee(s) have "full discretion and authority with regard to the investment of the Trust Fund, except with respect to a Plan asset under the control of a properly appointed Investment Manager, or with respect to a Plan asset properly subject to Employer, or to Participant direction of investment." Cordello Decl., Exs. 34 at ¶ 10.03; 35, at ¶ 2. The assets in the 401(k) Portfolio are not under the control of an Investment Manager, nor are they properly subject to Employer or Participant direction of investment. Cordello Decl., ¶ 48.

## III. ARGUMENT

### A. NEITHER THE CONFIRMATION ORDER, THE PLAN OF REORGANIZATION, NOR ANY OTHER AGREEMENT PURPORTS TO CONFER ON ML MANAGER ANY INTEREST IN OR RIGHT WITH RESPECT TO THE IMPOUNDED FUNDS.

In response to the 401(k) Plan's application for an order to show cause, ML Manager argued that (i) the impound accounts were under its control pursuant to applicable agency agreements, and (ii) under Paragraph U of the confirmation order and the agency agreement it has the right "to chargeback and allocate expenses and costs of the bankruptcy and the exit financing to the 401(k) Plan as a Pass-Through Investor . . . ." Dkt. 2819, at 2. Before turning to the discussion in Section B of why these arguments fail under ERISA as a legal matter, we explain why they also lack any basis in fact.

To the extent ML Manager relies upon any right under an agency agreement (and it is unclear what right that might be), its argument is foreclosed by the irrefutable fact that

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the Ecco and Hurst Servicing Agent Agreements – the documents under which the impound agreements were created (¶ 1.f.) -- have terminated by their terms because the properties have vested in the 401(k) Plan.[6]

No more availing for ML Manager is its argument based on the confirmation order. Paragraph U of the confirmation order permits charge-backs against "Pass-Through Investors who retain their fractional interests in the ML Loans . . . ." Both "Pass-Through Investor" and "ML Loans" are specifically defined in the Plan of Reorganization, and those definitions are fatal to ML Manager's position.

Under the Plan, a "Pass-Through Investor" must hold a "direct fractional or participating interest in the ML Loans . . . ." Plan of Reorganization ("POR"), Dkt. 1532, ¶ 2.63. "ML Loans" are the loans evidenced by "ML Notes" and "ML Deeds of Trust." *Id.* ¶ 2.52. "ML Notes" are promissory notes evidencing loans *from the Debtor* to third-party Borrowers . . . ." *Id.*, ¶ 2.54 (emphasis added). "ML Deeds of Trust" secure "ML Notes." *Id.*, ¶2.50. Thus, to be a "Pass-Through Investor," one must hold an interest in a loan from Mortgages, Ltd. to a third party. The 401(k) Plan does not hold such an interest. Each of the loans in the 401(k) Portfolio was made *by the 401(k) Plan*, not by Mortgages, Ltd. Thus the 401(k) Plan is in a fundamentally different position from the investors who acquired interests in loans made by Mortgages, Ltd., and it is not subject to chargebacks for exit financing under Paragraph U of the confirmation order.

That the plain language of the POR that exempts the 401(k) Plan from any such chargeback is no accident. Even apart from the requirements of ERISA, the exemption is inherent in the rationale for the structure of the POR. As was addressed in detail in the Disclosure Statement for the POR, a key controversy in this case concerned titled to the

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[6] Even if the Master Agency Agreement somehow created such a right in ML Manager -- which it does not and cannot -- it too has been terminated, both by the action of the 401(k) Plan's Trustee, and by its own terms as a result of the foreclosures of the Ecco and Hurst properties. Cordello Decl., ¶ 47, Ex. 30, ¶ 3(b).

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over $730 million in Notes that were "sold by the Debtor to Investors" and "endorsed to the Investors in their fractional interests." Dkt. 1471, at 61. The POR resolved this controversy "in favor of the Investors." *Id.* at 62.

But this controversy had nothing whatever to do with the 401(k) Plan because its loans *were not* sold to it by Mortgages, Ltd. Unlike the other investors in "ML Loans," the 401(k) Plan was not faced with any challenge to its title to its loans, and therefore did not receive the benefit that "Pass-Through Investors" did of a resolution of such a challenge through the POR. It therefore would have been anomalous for the 401(k) Plan to be treated as a "Pass-Through Investor" under the POR, and, the plain language of the POR makes it clear that the 401(k) Plan is not a "Pass-Through Investor." Accordingly, there is no basis to charge the 401(k) Plan or its assets for exit financing or any other matter under Paragraph U of the Confirmation Order or otherwise under the POR.

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**B. THE INTEREST CLAIMED BY ML MANAGER IS CATEGORICALLY PROHIBITED BY ERISA. INDEED, IF ML MANAGER HELD THE RIGHTS IT CLAIMS WITH RESPECT TO THE ESCROWED FUNDS, ML MANAGER AND THE INDIVIDUALS INVOLVED IN THE EXERCISE OF THOSE RIGHTS WOULD BECOME ERISA FIDUCIARIES FOR THE 401(K) PLAN AND WOULD IMMEDIATELY BE SUBJECT TO THE FULL PANOPLY OF REMEDIES PROVIDED FOR BY ERISA FOR BREACH OF FIDUCIARY DUTY AND IMPLEMENTATION OF A PROHIBITED TRANSACTION.**

Even if the Confirmation Order, the POR or any other document were construed to confer on ML Manager an interest in the impound funds, then ML Manager would find itself in violation of several provisions of the Employee Retirement Income Security Act of 1974, 29 U.S.C §§ 1001 *et seq.* ("ERISA"). We first address some of the provisions of ERISA that bear on the point and then turn to their application to the matter at hand.

ERISA regulates and protects employee pension benefits[7] through a "comprehensive and reticulated" statutory scheme. *Mertens v. Hewitt Assocs.*, 508 U.S. 238, 251 (1993). ERISA regulates both traditional "defined benefit" ("DB") pension

[7] ERISA also protects other types of benefits, called welfare benefit plans, *see* ERISA § 3(3) here.

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plans, that is plans which promise, upon retirement, a certain lifetime benefit based on various factors, and "defined contribution" ("DC") pension plans, such as the 401(k) Plan at issue here. ERISA §§ 3(1), (34), and (35), codified at 29 U.S.C. §§ 1002(1), (34), and (35). These DC plans promise "retirement income to employees," but they do not promise a certain benefit. Instead the amount available on retirement depends solely on the balance in an individual's account, reflecting the amount deposited (or withdrawn) by the employee, any amounts "matched" by the employer, and the investment return (or loss). As the Supreme Court has recently pointed out, such plans are now the dominant form of retirement savings (aside from Social Security) in the United States. *LaRue v. DeWolff, Boberg & Assocs., Inc.*, 552 US 248, 255 (2008).

ERISA protects the assets in pension plans in a variety of ways, three of which are particularly germane here:

1. ERISA requires that the assets of pensions plans be held in trust, thereby insulating them from claims of third parties, including creditors of the plan sponsor;

2. ERISA imposes stringent fiduciary duties upon those who hold or exercise discretion with respect to plan assets, and specifically prohibits certain transactions, including those that would divert plan assets to benefit plan fiduciaries or other parties in interest;

3. ERISA preempts state laws that either relate to pension plans or conflict with ERISA.

Each of these protections operates in this case to prohibit any charge back of the exit financing to the 401(k) Plan's assets.

***1. ERISA Requires that Plan Assets be Held in Trust, and Thereby Insulates Plan Assets From the Liabilities of the Plan Sponsor or Other Third Parties.***

A fundamental feature of ERISA is the requirement that pension plan assets be held in trust.

ERISA § 403(a), 29 U.S.C. § 1103(a) ("[A]ll assets of an employee benefit plan shall be held in trust by one or more trustees."); *see also* ERISA § 302, 29 U.S.C. § 1082.

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This protection has broad implications, for example, it greatly reduces the ability of a plan's managers to self-deal, and provides a framework for the fiduciary structure described in more detail below. Critically important here, by requiring that pension plan assets be held in trust, ERISA puts those assets beyond the reach of third parties, including the plan sponsor and its creditors.[8]

ML Manager seeks to do exactly what the trust structure of ERISA prevents: the raiding of plan assets to meet outside liabilities. The exit financing is not an obligation of the 401(k) Plan, and charging the 401(k) Plan for any portion of the exit financing would be no different from allowing any employer to raid a pension plan to meet the employer's liabilities. Once assets become plan assets, they can be used only for the purpose of providing plan benefits, they cannot be used to satisfy non-plan liabilities. ERISA § 404(a)(1)(A), 29 U.S.C. § 1104(a)(1)(A).

***2. ERISA's Fiduciary Regime Further Protects the 401(k) Plan's Assets Here.***

In support of the trust structure described above, ERISA imposes upon pension plans a comprehensive and demanding fiduciary responsibility regime. The scheme is comprehensive through the broad scope of the definition of an ERISA fiduciary; it is exacting by virtue of the duties imposed on ERISA fiduciaries, and remedies provided for breach of those duties; and it categorically prohibits a charge back of the type ML Manager urges here.

We begin with the definition of a fiduciary. One of the most significant features of ERISA is its broad, real-world concept of a fiduciary, ERISA § 3(21), which is couched not in terms of one’s formal title or designation in the plan documents, but in terms of what one in fact does. Under ERISA “a person is a fiduciary with respect to a plan *to the extent* . . . he exercises *any* discretionary authority or discretionary control respecting

[8] A corollary feature of ERISA is the anti-alienation provision, which protects a participant's interest in a plan from claims of creditors. ERISA § 206(d), 29 U.S.C. § 1056(d).

management of such plan or exercises any authority or control respecting management or disposition of its assets . . . or . . . has *any* discretionary authority or discretionary responsibility in the administration of such plan." ERISA § 3(21), 29 U.S.C. § 1002(21).

This could hardly be broader, and fiduciary status does not depend on whether one intended to be a fiduciary. What matters is what one does. As the Supreme Court has emphasized, this provision of ERISA "defines 'fiduciary' not in terms of formal trusteeship, but in functional terms of control and authority over the [plan]." *Mertens* 508 U.S. at 262 (1993).

Not only is the definition broad, it contemplates that a given plan will have many fiduciaries with many functions. As the leading ERISA treatise puts it, this "fractionation of trusteeship" is one of the major features of ERISA, which "envisions multiple fiduciary service providers, and the complexity of ERISA's definition of fiduciary . . . responds to the dispersion of fiduciary functions that ERISA permits." Langbein, Pratt & Stabile, Pension and Employee Benefit Law at 548. Or as the Supreme Court put it, "Congress commodiously imposed fiduciary standards on persons whose actions affect the amount of benefits retirement plan participants will receive." *John Hancock Mut. Life Ins. Co. v. Harris Trust and Sav. Bank*, 510 US 86, 96 (1993).

Once it is determined that a person is an ERISA fiduciary, the consequences are significant. Section 404 of ERISA imposes certain obligations on fiduciaries. ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1). Of particular relevance here are the statutory directives that a "fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries" and shall do so "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."

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These fiduciary duties of loyalty and prudence are "the highest known to the law." *Johnson v. Couturier*, 572 F.3d 1067, 1077 (9th Cir. 2009). Breach of them subjects a fiduciary to suit under section 502(a)(2) of ERISA, and the remedies for breach, spelled out in section 409 of ERISA, are very broad. ERISA §§ 409, 502(a)(2), 29 U.S.C. §§ 1109, 1132(a)(2). Most notably, a breaching fiduciary of a plan "shall be personally liable to make good to such plan any losses to the plan resulting from each such breach."

Fiduciaries are subject not only to the general fiduciary obligations of section 404, but also to the much more specific obligations of the ERISA § 406. ERISA §406, 29 U.S.C. § 1106. That provision of ERISA categorically bans certain transactions ("prohibited transactions" in the language of the statute), without the need for any generalized inquiry into the prudence of the transactions. The statute particularly targets, and prohibits, transactions between a plan and a "party in interest," which is very broadly defined to include, among others, the employer and fiduciaries, and states that

> "A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect . . . transfer to, or use by or for the benefit of a party in interest, of any assets of the plan."

ERISA § 406 (a)(1)(D).

Like other fiduciary breaches, permitting or causing a plan to enter into a prohibited transaction subjects a fiduciary to suit under section 502(a)(2) of ERISA, and to the broad the remedies for breach described above.

***i. If ML Manager Holds the Rights It Claims, ML Manager and the Individuals in Control of ML Manager Would Be Fiduciaries of the 401(k) Plan and Would Be Immediately Liable to the 401(k) Plan for Any Chargeback Against Its Assets***

Here, ML Manager proposes to do one of the things ERISA flatly prohibits – raid the assets of a plan to meet non-plan obligations. Such an action is specifically prohibited by ERISA § 406, and would constitute a breach of fiduciary duty under general fiduciary standards of prudence and loyalty. That ML Manager would be a fiduciary under ERISA



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were it to take the action of charging the 401(k) Plan for exit financing is definitional: if ML Manager has the authority over the 401(k) Plan's assets to do so, then it is a fiduciary.[9]

As a fiduciary, ML Manager would be required to act "solely in the interest of the participants and beneficiaries." Plainly diverting a significant part of the Plan's assets to fund the exit financing is not in the interest of participants and beneficiaries. Nor is doing so a prudent course of action. If ML Manager truly does seek to divert the funds, it and the individuals at whose direction the action was taken will be vulnerable to suit under section 502(a)(2) of ERISA and obliged, by virtue of section 409 of ERISA, to restore, from their own pockets, the losses suffered by the Plan.

And aside from these general fiduciary duties, the proposed transaction is a prohibited transaction under ERISA § 406. As noted above, § 406 provides that "a fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect . . . transfer to, or use by or for the benefit of a party in interest, of any assets of the plan." As a fiduciary, ML Manager would be a party in interest. ERISA § 3(14). ML Manager has made no secret in other filings with the Court that it would benefit from the use of funds to pay the exit financing, for which it is a co-borrower. *See*, *e.g.*, *ML Manager's Resp. to the Counterclaimant's Motion for Partial Summary Judgment*, Adv. Pro. No. 2:10-ap-00430-RJH ("Hawkins Resp."), at 9 ("ML Manager Is a Co-borrower for the Exit Financing, and Has the Right to Use Money From the Loans to Repay its Obligations."). The chargeback against the 401(k) Plan's assets for exit financing would be flatly prohibited by ERISA.

### *ii. Nor Can ML Manager Rely on Any Right Under an Agency Agreement to Chargeback the 401(k) Plan or Otherwise Assert Authority Over Assets of the 401(k) Plan.*

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[9]Likewise, the individuals in control of ML Manager would also be fiduciaries under the functional definition of fiduciary discussed above, and they would be jointly and severally liable with ML Manager for breach of fiduciary duty. ERISA § 405, 29 U.S.C. § 1105.

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Based on its response to the 401(k) Plan's application for an order to show cause, ML Manager appears to base its asserted right to assess the 401(k) Plan for exit financing expenses at least in part on an agency agreement. While the 401(k) Plan is aware of no such agency agreement that purports to confer such a right, even if one existed it would be of no effect here for at least 2 reasons. First, all agency agreements between the 401(k) Plan and Mortgages Ltd. have been terminated by their own terms and/or by action of the 401(k) Plan Trustee, Cordello Decl. Ex. 30, ¶ 3(b); ¶ 47, and, as discussed below the arguments that ML Manager has urged in other settings regarding the irrevocability of other agency agreements are preempted by ERISA. Second, the Master Agency Agreement is void *ab initio* as a prohibited transaction under ERISA, and any agency agreement that creates an "interest" in favor of ML Manager would also be void as a prohibited transaction.

On its face, the Master Agency Agreement provides for compensation to Mortgages Ltd. in the form of diversion of certain amounts paid by the borrowers under their loans from the 401(k) Plan. Such compensation is specifically prohibited by ERISA § 406, and these provisions therefore render the Master Agency Agreement void *ab initio.*[10] *See Wilson v. Perry*, 470 F.Supp.2d 610, 618-25 (E.D. Va. 2007) (voiding lease with fiduciary as prohibited transaction); *Iron Workers Local 25 Pension Fund v. Watson Wyatt and Co.*, 2009 WL 3698562 *7 (E.D. Mich. 2009) (denying motion to dismiss claim for declaratory judgment that prohibited transaction was void). Moreover, *any* arrangement whereby an "interest" arises in favor of Mortgages Ltd. (or ML Manager) so

[10] While ERISA § 408 exempts from the prohibited transaction provisions of § 406 the payment of "reasonable compensation" to a party in interest for services to a plan, the burden of establishing such reasonableness lies with the recipient, *Lowen v. Tower Asset Mgmt., Inc.*, 829 F.2d 1209, 1215 (2d Cir. 1987), and it difficult to imagine how the kind of open-ended compensation provisions as are set forth in the Master Agency Agreement could ever be seen as qualifying for this exemption.

as to allegedly support irrevocability of an agency agreement would be void as a prohibited transaction for the same reason.

***3. ERISA Preempts Any State Law That Would Limit the Ability of a 401(k) Plan Trustee to Terminate an Agency Agreement.***

The 401(k) Plan is well aware of the extent of the proceedings that have occurred in this Court with respect to the purported termination of the agency relationship between Mortgages, Ltd. and certain investors in its loans. But the various arguments raised in that context – particularly those concerning whether the agency is "coupled with an interest" and therefore irrevocable—are of no moment here for several reasons. First, as just discussed, the very existence of such an "interest" would render the arrangement void as an ERISA prohibited transaction.

Second, the facts here are plainly distinguishable from those considered by the Court in other contexts. Unlike Pass-Through Investors, the 401(k) Plan is party to no agency agreement that states it is "coupled with an interest." Further, factors that have been stressed by ML Manager in its arguments for irrevocability of other agency agreements[11] and relief upon by the Court in finding irrevocability[12] are not present here. Specifically, because the 401(k) Plan made its loans to the borrowers, Mortgages Ltd. cannot be said to have reserved any interest spread or other rights so as to constitute an "interest" to support irrevocability.

Moreover, to the extent that Arizona law would operate to limit the ability of the 401(k) Plan Trustee to terminate any agency agreement, such state law would be preempted by ERISA. ERISA § 514 expressly preempts state laws "insofar as they may now or hereafter relate to any employee benefit plan," ERISA § 514, 29 U.S.C. § 1144. Whether a law "relates to" employee benefit plans is a "two-part inquiry: a law 'relates to'

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[11] Hawkins Resp., at 7-9.

[12] July 27, 2010 Declaratory Judgment entered in Adv. Pro. No. 2:10-ap-00430-RJH, ¶¶ 65 – 69.

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a covered employee benefit plan for purposes of § 514(a) 'if it [1] has a connection with or [2] reference to such a plan.'" *Cal. Div. of Labor Standards Enforcement v. Dillingham Construction, N.A., Inc.*, 519 U.S. 316, 324 (1997). The Supreme Court has also ruled that ERISA impliedly preempts other state laws that conflict with ERISA, e.*g.*, *Boggs v. Boggs*, 520 US 833 (1997) (state law in conflict with ERISA plan's beneficiary designation procedures preempted), as well as state laws that infringe on areas of core ERISA concern. *Egelhoff v. Egelhoff ex rel. Breiner*, 532 U.S. 141, 147 (2001) (state statute purporting to dictate who was an ERISA beneficiary preempted because it implicated "an area of core ERISA concern."). The construction of Arizona law offered by ML Manager impermissibly relates to employee benefit plans, conflicts with ERISA, and infringes on an area of core ERISA concern.

Courts have routinely held state laws that bind ERISA plans or plan fiduciaries regarding areas of core ERISA concern to be preempted. *Metropolitan Life Ins. Co. v Pettit*, 164 F.3d 857, 862 (4th Cir. 1998) (ERISA preempts state laws "that bind employers or plan administrators to particular choices or preclude uniform administrative practice, thereby functioning as a regulation of an ERISA plan itself"); *Stevenson v. Bank of New York Co., Inc.*, 609 F.3d 56, 61 (2d Cir. 2010) ("Because [the state law in question] neither interferes with the relationships among core ERISA entities nor tends to control or supersede their functions, it poses no danger of undermining the uniformity of the administration of benefits that is ERISA's key concern.").

In this case the 401(k) Plan Trustee sent notice that the 401(k) Plan had terminated the Master Agency Agreement on June 3, 2009. Cordello Decl., Ex. 31. As Trustee, Mr. Olson was a "named fiduciary" of the 401(k) Plan. Cordello Decl., Ex. 34 at 10.03(D). Under § 402 of ERISA, the named fiduciaries of a plan have "authority to control and manage the operation and administration of the plan." This authority extends to determining who to retain as fiduciary for the plan.

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If Arizona law were to deny Mr. Olson the ability to terminate the Master Agency Agreement, and thus terminate ML Manager as a fiduciary for the Plan, on the basis that the Master Agency Agreement is irrevocable under state law (which is the argument advanced by ML Manager in its response to the show cause application), or for any other reason (including any requirement that ML Manager join in the termination) then the 401(k) Plan's named fiduciary's ability to control and manage the operation and administration of the 401(k) Plan would be frustrated in contravention of ERISA § 402. Thus ML Manager's argument would allow state law to *irrevocably* dictate who was a fiduciary of an ERISA plan, which obviously infringes on an area of core ERISA concern and would bind ERISA plan administrators and plan sponsors regarding how to administer ERISA plans. This application of Arizona law advocated by ML Manager is both expressly preempted by ERISA § 514 because of its impermissible connection with ERISA plans, and is impliedly preempted by ERISA because it conflicts with ERISA's fiduciary administration and impermissibly infringes on an area of core ERISA concern.

**IV. CONCLUSION**

For the reasons set forth above, ML Manager has no right, and under ERISA can have no right, to charge exit financing or other non-401(k) Plan expenses to the 401(k) Plan's assets. Accordingly, the existing impound accounts should be released to the 401(k) Plan immediately.

DATED this 9th day of August, 2010.

KELLER ROHRBACK, P.L.C.

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# CERTIFICATION

I hereby certify that this **Motion of Mortgages Limited 401(k) Plan for Order Directing Release of Funds, and Memorandum in Support Thereof** was filed through the ECF system for the United States Bankruptcy Court in Arizona, and will be sent electronically to the registered participants on the Notice of Electronic Filing on August 9, 2010. Paper and/or disk copies, if any, will be sent by first class mail to those indicated as non-registered participants on August 9, 2010.

By /s/ Karen L. Trumpower