

SIGNED.



Dated: May 19, 2009

Randolph J. Haines

RANDOLPH J. HAINES
U.S. Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA

In re)	Chapter 11
MORTGAGES LTD.,)	CASE NO. 2:08-bk-07465
)	
Debtor.)	
_____)	
NATIONAL RETAIL DEVELOPMENT PARTNERS I, LLC,)	ADVERSARY NO. 2:08-ap-00780-RJH
)	
Plaintiff,)	
v.)	
ALAN J. MANESS, et al.,)	
)	
Defendants.)	
_____)	
PDG LOS ARCOS, LLC, an Arizona limited liability company,)	ADVERSARY NO. 2:08-ap-00781-RJH
)	
Plaintiff,)	
v.)	
ROBERT M. ADAMS, et al.,)	OPINION AND ORDER GRANTING MOTION TO DISMISS
)	
Defendants.)	
_____)	

The issue here is whether, under Arizona law, a bare assignment of a contract implies an assumption of duties. The Court concludes that it does not, at least in the circumstance where the assignment is for purposes of financing, and therefore grants the defendants' motion to dismiss.

Factual and Procedural Background

Mortgages Ltd. was in the business of making "hard money" commercial loans of

1 money raised from its investors. In fact, it is alleged to hold the State's oldest mortgage
2 brokerage license. Unfortunately it continued to make such loans even after a serious decline in
3 Arizona's real estate market and ultimately committed to more loans than it could fund. Its
4 CEO, the son of the founder, committed suicide in June, 2008, and an involuntary bankruptcy
5 petition was filed within a couple of weeks thereafter. In its currently pending Chapter 11 case
6 there are close to \$1 billion in outstanding loans but less than 10% of them are performing.

7 Two of its loan commitments were a \$26 million construction loan agreement with
8 plaintiff PDG Los Arcos, LLC. ("PDG") and a \$10 million construction loan agreement with
9 plaintiff National Retail Development Partners, LLC ("NRDP") in June and August of 2007,
10 respectively. The loans were both documented with loan agreements, promissory notes, deeds
11 of trust, guarantees and other documents.

12 For months after the loan agreements were made Mortgages Ltd. sold investments
13 in the loans to raise the money to fund them. These investments were sold pursuant to private
14 offering memoranda that described Pass Through Loan Participations. In both cases there was a
15 Promissory Note Indorsement and an Assignment of Beneficial Interest Under Deed of Trust
16 assigning fractional interests in the notes and deeds of trust, some as small as 0.004%, to
17 numerous investors who are the defendants in these adversary proceedings. And, in addition to
18 the endorsement of fractional interests in the promissory note and its security, in each case there
19 was also an Assignment stating that "Assignor [Mortgages Ltd.] hereby assigns to Assignee the
20 above-referenced interest in the following documents," which included the Construction Loan
21 Agreement.

22 The loans were not fully funded by the time of the Mortgages Ltd. bankruptcy.
23 The PDG loan had only been funded to the extent of approximately 50%, and the NRDP loan
24 had been 90% funded. A few months after the bankruptcy NRDP and PDG filed suit against the
25 investor/assignees, alleging that the investors were liable under the assignment of the
26 construction loan agreement to fully fund the loan. The complaints assert that "each defendant
27 [investor/assignee] took an assignment of a proportional interest in the construction loan
28 agreement and the associated loan documents and assumed a proportionate share of the rights

1 and obligations under the various loan documents association with the construction loan.”

2 Defendants removed the cases to bankruptcy court and have filed motions to
3 dismiss. The motions contend that the complaints fail to satisfy the pleading requirements to
4 state a claim that defendants were delegated or assumed any duty to fund the loans, and that a
5 mere assignment of a contract does not include or imply a delegation of duties.

6 **Arizona Has Precedent Contrary to the Restatement’s Rule of Implied Delegation.**

7 The parties agree the issue is governed by Arizona law. Plaintiff contends this
8 court should predict that Arizona would follow the rule of the Restatement (Second) of Contracts
9 § 328, which provides that an assignment of a contract presumptively implies a delegation of its
10 duties:

11 (1) Unless the language or the circumstances indicate the
12 contrary, as in an assignment for security, an assignment of
13 “the contract” or of “all my rights under the contract” or an
14 assignment in similar general terms is an assignment of the
15 assignor's rights and a delegation of his unperformed duties
16 under the contract.

15 (2) Unless the language or the circumstances indicate the
16 contrary, the acceptance by an assignee of such an
17 assignment operates as a promise to the assignor to perform
18 the assignor's unperformed duties, and the obligor of the
19 assigned rights is an intended beneficiary of the promise.

18 The parties also agree that “Arizona courts look to the Restatement for guidance
19 in the absence of controlling authority” to the contrary.¹ The first issue, therefore, is whether
20 there is controlling authority to the contrary.

21 In 1925, the Arizona Supreme Court adopted “a general principle that the
22 assignment [of a contract] does not have any such effect” of casting “on the assignee the
23 liabilities imposed by the contract on the assignor.”² One stated reason for this rule was that
24 the assignment cannot have the effect of creating a new liability on the part of the assignee to
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26 ¹ *Tierra Ranchos Homeowners Ass’n. V. Kitchukov*, 216 Ariz. 195, 201, 165 P.3d 173, 179
27 (App. 2007). *Accord, In re Krohn*, 52 P.3d 774, 779 (Ariz. 2002)(“where we are not bound by our
28 previous decisions or by legislative enactment, we follow the Restatement of the Law”).

² *Grant v. Harner*, 29 Ariz. 41, 43-44, 239 P. 296, 297-97 (1925).

1 the other party to the contract “because the assignment does not bring them together, and
2 consequently there cannot be the meeting of minds essential to the formation of a contract.”³

3 In 1981, the Arizona Supreme Court reiterated that *Grant* established this
4 “general principle.”⁴ While that opinion in *Norton* suggested that “it would be logical for us to
5 recognize an implied assumption of duties by an assignee,” the opinion made very clear that
6 “the circumstances of this case, however, do not require us to reach that question.”⁵ Indeed, the
7 opinion was unequivocal that it was not thereby adopting the Restatement rule by its use of the
8 counterfactual or hypothetical subjunctive tense in noting that “Even if the Restatement rule
9 were adopted in Arizona,” it would not apply to the facts before the court where the assignment
10 of interests in real property “makes no reference” to an assignment of contracts.⁶

11 Because *Norton* did not adopt the Restatement rule and *Grant* is controlling
12 precedent in which the State’s highest court adopted the contrary rule, this Court is bound by
13 the rule of *Grant* that an assignment alone does not imply a delegation or assumption of duties.
14 Given the precedent of *Grant*, the Court cannot conclude that an assignment of a contract
15 operates to cast on the assignee the assignor’s liabilities.

16 **Plaintiffs Are Not Third Party Beneficiaries of the Assignments.**

17
18 This conclusion is further bolstered by another principle applied in *Norton* where
19 the court did not even suggest it might be “logical” to adopt the contrary Restatement rule. The
20 analysis in *Norton* began with reference to the well-established “Arizona rule” that “for a
21 person to recover as a third-party beneficiary of a contract, an intention to benefit that person

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23 ³ *Id.*

24 ⁴ *Norton v. First Federal Savings*, 128 Ariz. 176, 181, 624 P.2d 854, 859 (1981)(“We have
25 stated, as a general principle, that an assignment of a contract does not operate to cast on the assignee
26 liabilities imposed by the contract on the assignor. *Grant v. Harner*, 29 Ariz. 41, 239 P. 296 (1925). A
review of cases from other jurisdictions discloses that many courts agree with this basic rule.”).

27 ⁵ *Id.*

28 ⁶ *Id.*

1 must be indicated in the contract itself.”⁷ That “Arizona rule” independently bars the plaintiffs’
2 claim here because they are not parties to the assignments between Mortgages Ltd. and its
3 investors. At best, they could only claim to be third party beneficiaries of those assignments.
4 But there is nothing in those assignments that indicates an intent to directly benefit the
5 borrowers such as PDG and NRDP.

6 Although the second part of the Restatement rule establishes a special third party
7 beneficiary rule for the context of contract assignments, it is not a necessary part of the first
8 part of the Restatement rule that an assignment of rights implies a delegation of duties. That
9 rule of implied delegation, for example, could have application in a suit by the assignor against
10 the assignee for the assignee’s failure to perform the obligations due the other party to the
11 underlying contract. Such a suit could be decided by application of the first part of the
12 Restatement rule and would not involve the second, special rule on third party beneficiary
13 rights.

14 When the suit is brought by the other party to the contract, however, it must
15 establish *both* that the assignment implied a delegation of duties and that it is entitled to enforce
16 such rights arising from the assignment to which it was not a party, *i.e.*, that it has the rights of
17 a third party beneficiary. While the hypothetical discussion in *Norton* suggested it might be
18 “logical” for Arizona courts to adopt the implied delegation of duties it does not suggest, or
19 even consider, whether it would also be logical to overrule Arizona’s long-standing rule
20 governing third party beneficiaries.

21 **The Assignment for Financing Negates an Implied Delegation of Duties.**

22 Even if this Court were to conclude that Arizona would follow the Restatement of
23 Contracts § 328, this would not imply a delegation of duties under the factual circumstances
24 presented by the complaint. The Restatement rule indicates that an “assignment for security” is
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27 ⁷ *Id.*, citing *Irwin v. Murphey*, 81 Ariz. 148, 302 P.2d 534 (1956). “The contemplated benefit
28 must be both intentional and direct, *Irwin, supra, Treadway v. Western Cotton Oil Etc. Co.*, 40 Ariz.
125, 10 P.ed 371 (1932), and ‘it must definitely appear that the parties intend to recognize the third
party as the primary party in interest.’” *Id.*

1 an example of “circumstances” that “indicate the contrary,” *i.e.*, that the assignment did not
2 imply a delegation of duties. Here, it is undisputed that the purpose of the assignments to the
3 investors was to raise the funds with which to fund the loans.

4 It could be argued that the assignments to the pass through investors were not
5 assignments “for security” because they were intended to become the owners of the fractional
6 interests in the notes rather than lenders secured by security interests in those notes. But the
7 Court does not interpret the Restatement’s term “assignment for security” to be so technically
8 limited to a security interest but rather more generically to refer to any transaction intended to
9 make the assignee’s investment a secure one. Modern accounts receivable financing evolved
10 from factoring in which the accounts were sold outright to the factor. It would not be logical to
11 assume that the Restatement’s language was intended to make a fine distinction between these
12 two methods of documenting such financing. And an important policy underlying both the
13 Restatement rule and Uniform Commercial Code § 9-404⁸ was to “not twist the ‘precarious
14 security’ of an assignee into potential liability for this assignor’s breach” because “by making
15 the bank a surety, not only will accounts receivable financing be discouraged, but transaction
16 costs will undoubtedly increase for everyone.”⁹

17 Here, the transaction documents, especially the Private Offering Memoranda,
18 make abundantly clear this was a financing transaction akin to the resale of collateralized debt
19 obligations in the securities markets. It was not, for example, a purchase of the business of
20 Mortgages Ltd. where the buyer intended to take over the lending business and with it the
21 obligation to fund outstanding loan agreements. Consequently even if Arizona were to adopt
22 the Restatement rule there would be no presumptive delegation of duties to the investors, and
23 therefore the complaint fails adequately to plead any facts sufficient to state a claim by the
24 borrower against the investors.

26 ⁸ In Arizona, A.R.S. § 47-9404, formerly A.R.S. § 47-9317 (U.C.C. § 9-317).

27 ⁹ *Michelin Tires (Canada) Ltd. v. First Nat’l Bank of Boston*, 666 F.2d 673, 678, 679 (1st Cir.
28 1981).

1 **Conclusion.**

2 For these three reasons, each of which would be sufficient in itself, the complaint
3 fails to state a claim against the investors. The investors' motion to dismiss is therefore
4 granted.

5 DATED AND SIGNED ABOVE

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7 Copy of the foregoing e-mailed
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