

# USA CAPITAL DIVERSIFIED TRUST DEED FUND, LLC

Robert G. Worthen, Chairman of the Board

March 7, 2011

Dear USA Capital Diversified Trust Deed Fund, LLC Investor:

I again write with an update on behalf of the Board of Directors of USA Capital Diversified Trust Deed Fund, LLC (“DTDF”). We continue to focus on recovering funds and on the investigation and prosecution of causes of action against potential recovery targets. This letter builds off of the information provided in the previous letters and covers the following topics:

1. 2010 K-1 & Instructions
2. Status of the 2009 Theft Loss Determination Requested from IRS and Examination
3. Recovery Efforts
  - A. Settlement with USA Commercial Mortgage Trust (“USACM”)
  - B. Investigating and Prosecuting Causes of Action against Potential Target Defendants
  - C. Advocating DTDF Interests in Other Bankruptcy Cases
4. Insiders - Thomas Hantges and Joseph Milanowski
5. Status of Other Recovery Sources
6. Distributions
7. Communications with DTDF Investors

## 1. 2010 K-1

Stewart, Archibald and Barney, LLP prepared DTDF’s 2009 tax return, and DTDF has retained that firm to prepare the 2010 tax return and K-1’s for individual members. Enclosed please find your K-1 from DTDF, along with the K-1 Partnership Instructions for 2010.

## 2. Status of Theft Loss Determination Requested from IRS for tax year 2009 and Examination

DTDF received a Private Letter Ruling (“PLR”) from the IRS dated December 28, 2010. The PLR concluded the following:

1. DTDF is the qualified investor for purposes of claiming a theft loss deduction under Rev. Proc. 2009-20.
2. The discovery year for purposes of claiming a theft loss deduction under Rev. Proc. 2009-20 is 2009.

A copy of the PLR can be found on DTDF’s website at <http://usacapdtdf.bmcgroup.com/default.aspx> or can be obtained by sending a written request to the address provided in section 7 of this letter.

DTDF received a letter from the IRS in February 2011 indicating the IRS is starting an administrative proceeding at the partnership level of DTDF. This means the IRS is beginning an examination (audit) of DTDF’s 2009 tax return. Any adjustment the IRS makes to DTDF’s 2009 tax return may affect your personal tax liability. We will keep you informed of the audit findings.

The Internal Revenue Service (“IRS”) sent a letter dated March 2, 2011 to DTDF investors regarding the IRS’s decision to not take action on DTDF’s Administrative Adjustment Request. This letter is in response to the protective claim filed by DTDF on March 15, 2010 for the 2006 tax year. DTDF reported a theft loss on its 2009 tax return which is supported by the PLR provided by the IRS and mentioned above. Therefore, DTDF is not currently pursuing any adjustments to its 2006 tax return.

Treasury Disclosure: Any advice contained herein was not intended or written to be used, and cannot be used, for the purpose of avoiding U.S. federal, state or local tax penalties. Unless otherwise specifically indicated above, you should assume that any statement in this letter relating to any U.S. federal, state, or local tax matter was written in connection with the promotion or marketing by other parties of the transaction(s) or matter(s) addressed in this letter. Each taxpayer should seek advice based on the taxpayer’s particular circumstances from an independent tax advisor.

### **3. RECOVERY EFFORTS**

#### **A. Settlement with USA Commercial Mortgage Trust (“USACM”)**

As described in prior letters, DTDF and USACM reached a settlement in early 2008 where DTDF received a \$128 million unsecured claim in the USACM estate, and agreed to share DTDF and USACM net litigation recoveries. Litigation recoveries are split 50% to DTDF and 50% to USACM up to \$20 million, and 35% to DTDF and 65% to USACM thereafter. That means that DTDF will receive future distributions from USACM both in the form of direct payment of its share of litigation proceeds and as a result of DTDF’s \$128 million unsecured claim. The amount and timing of future distributions is unknown.

#### **B. Investigating and Prosecuting Causes of Action against Potential Target Defendants**

DTDF and USACM continue to work together to pursue the few remaining lawsuits, as many of the cases already pursued by DTDF and USACM have concluded. The only remaining case where DTDF is or was a plaintiff is case number 02:08-CV-461 against Deloitte & Touche. Deloitte & Touche filed a motion for summary judgment that was submitted to the court after oral argument on August 30, 2010. On February 16, 2011, United States District Judge Pro granted Deloitte & Touche’s motion for summary judgment. This ruling was a disappointment to DTDF and USACM, who are considering whether to pursue an appeal.

#### **C. Advocating DTDF Interests in Other Bankruptcy Cases**

##### USAIP Chapter 11 (Case # 07-11821-LBR)

DTDF timely filed a proof of claim seeking \$176,380,998 from the USAIP estate. USAIP is making progress in resolving claims against the USAIP estate. It is unclear at this time what, if anything, will be distributed to the creditors of USAIP. DTDF continues to monitor the USAIP case, including reviewing its monthly operating reports.

Per the December Monthly Operating Report (most recent report filed), USAIP reported that it has approximately \$2.05 million in cash on hand with approximately \$1.18 million in unpaid post bankruptcy services, including professional fees.

##### Tree Moss Partners, LLC (“Tree Moss”) Chapter 11 (Case No. 06-13758-LBR)

On April 27, 2007 the Tree Moss Partners case was converted from a chapter 7 case to a case under chapter 11 of the Bankruptcy Code. DTDF filed a proof of claim for \$23,116,045 in the Tree Moss

case. Lisa Poulin is the chapter 11 trustee, and throughout the duration of the case has made significant efforts to market and sell the Tree Moss interest in sixty-three (63) units at the Marquis Villas.

The Trustee reached a Purchase Agreement with Diamond Resorts Palm Springs Development, LLC (current owner of the other thirty-eight (38) units at the Marquis Villas) and on August 20, 2010, filed a motion seeking Court approval of the sale of substantially all of the Tree Moss's assets to Diamond Resorts. Per the Purchase Agreement, Diamond Resorts will acquire the sixty-three (63) units for \$575,000 in cash. The motion was approved on September 23, 2010. Diamond Resorts was the 'stalking horse' bidder and other qualified bidders were welcome to participate in the Auction. Per the October 26, 2010 status report filed by the Trustee, no competing bidders submitted a competing bid, so an Auction was not held. The sale to Diamond Resorts has not closed, as the Trustee is working to resolve issues involving certain executory contracts and unexpired leases. A status hearing is scheduled for March 9, 2011.

#### HMA Sales, LLC Chapter 11 (Case No 07-12694)

As a result of the settlement agreement DTFD received \$8.9 million in 2007, and will receive additional monies from HMA. DTFD continues to monitor the HMA case and work with the HMA Sales trustee, Ms. Poulin, as well as with her counsel, to collect additional sums relating to the Royal Hotel.

#### BySynergy, LLC Chapter 11 (Case No. 08-7680-rtb)

DTDF filed an unsecured proof of claim on November 11, 2008 for \$4,758,823. On April 21, 2010, the US Trustee filed a motion to convert the case from one under chapter 11 to one under chapter 7. Subsequently, on August 23, 2010, the Debtor moved to dismiss the case since the property was foreclosed in late 2009 and no significant assets were left for reorganization or liquidation. To the contrary, in late 2010 BySynergy found a buyer Verdant Technology Solutions ("VTS"), to purchase BySynergy's remaining assets for \$3,100,000.

On December 17, 2010, BySynergy and its creditors reached a stipulation agreement. As part of the agreement, Verdant Technology Solutions ("VTS") would place \$3,100,000 in cash into an escrow account by January 14, 2011 and transfer a 5% profit participation in the net income from the development to the creditors. A committee would then determine the validity, priority and amount of each creditor claim seeking to receive a share of the proceeds funded into escrow and would oversee the distributions from the escrow to valid creditors as approved by the Court.

The sale has not closed, and on February 15, 2011 the Unsecured Creditors Committee filed a motion to convert the case to one under chapter 7, so the outlook for a large payout is not promising.

## **4. INSIDERS – THOMAS HANTGES AND JOSEPH MILANOWSKI**

### **1. Thomas Hantges**

Due to actions taken by DTFD, the USACM Liquidating Trust, and other creditors, Thomas A. Hantges was a debtor in a chapter 11 bankruptcy case in Nevada, Case No.07-13163-lbr. Michael Carmel was appointed trustee in the Hantges bankruptcy. On October 27, 2009, Mr. Carmel filed a motion to convert the case to one under chapter 7. The motion was approved, and the case was converted to one under chapter 7 on November 25, 2009. DTFD timely filed a proof of claim seeking \$182,538,254.

On February 11, 2008, Diamond McCarthy, one of DTDF's counsel, filed a complaint to determine non-dischargeability of debt against Hantges (Adversary No. 08-01041-lbr). Hantges answered the complaint and the matter is in the early discovery stages. Similar lawsuits were filed against Hantges by USACM Liquidating Trust (No. 08-01042), the Kehl family (No. 08-01040), and the United States Pension Benefit Guaranty Corporation ("PBGC") (No. 08-01039).

A settlement conference was held on October 21, 2010 at which time a status hearing was scheduled for November 17, 2010. DTDF did not settle with Mr. Hantges at the settlement conference, and will try the case against Hantges with its counsel, Diamond McCarthy LLP on June 21, 23, and 24, 2011. Diamond McCarthy LLP is also representing the USACM Liquidating Trust in its objection to discharge case filed against Hantges, Adversary Proceeding No. 08-0142-lbr, set for trial on June 21, 23, and 24, 2011 concurrently with DTDF.

## **2. Joseph Milanowski**

Joseph Milanowski became a debtor in a chapter 11 bankruptcy case in Las Vegas, Case No. 07-13162-lbr, as a result of DTDF, the USACM Liquidating Trust and others joining in bringing an involuntary bankruptcy petition against him. The Court entered an order for relief against Milanowski, and appointed Ford Elsaesser as the trustee.

Similar to the Hantges estate, on November 18, 2009, Mr. Elsaesser filed a motion to convert the chapter 11 case to one under chapter 7. The Bankruptcy Court approved the motion, and the case is now being administered as a chapter 7 liquidation. A new meeting of creditors and deadline to file proofs of claim was set in the chapter 7 case, as was a new deadline for complaints objecting to the debtor's discharge or dischargeability of debts.

DTDF timely filed a proof of claim against Milanowski, seeking \$182,538,254. DTDF also filed a complaint in the Bankruptcy Court, Adv. No. 08-01090-lbr, to determine the dischargeability of Milanowski's debts to DTDF. Similar lawsuits were filed against Milanowski by USACM Liquidating Trust (No. 09-01093), Aurora Investment L.P (No. 07-01212), the Kehl family (No. 08-01052), the PBGC (No. 08-01044), and BySynergy, LLC (No. 07-01209). A settlement of the claims asserted by the Trust, DTDF, the Kehl family and Aurora Investments, was tentatively reached in November 2010 after participation in a mandatory settlement conference in October 2010. A settlement agreement was negotiated, documented and executed in January, 2011. A motion seeking approval of the parties' settlement agreement was filed, heard and approved by the bankruptcy court on February 15, 2011.

Pursuant to the terms of the approved settlement, Milanowski agreed to a non-dischargeable judgment in the amount of Five Million Dollars (\$5,000,000.00) in favor of the USACM Trust and DTDF (the "Agreed Judgment"). Milanowski agreed to take any and all necessary steps to enter the Agreed Judgment in the Milanowski Bankruptcy Case. Diamond McCarthy has discussed the Agreed Judgment with Ford Elsaesser, the Trustee of the Milanowski bankruptcy case, who has agreed to allow the Agreed Judgment as a claim in the Milanowski bankruptcy estate. Diamond McCarthy is currently working with Ford Elsaesser to effectuate the execution, filing and stipulated allowance of the Agreed Judgment in the Milanowski bankruptcy estate. This Agreed Judgment is forever non-dischargeable until paid and/or otherwise satisfied. In addition, Milanowski is obligated under the terms of his settlement to provide full, complete, and unfettered assistance and cooperation to USACM and DTDF in connection with pending adversary proceedings against Hantges including such full, complete, and unfettered assistance and cooperation to any federal, state, and local authorities in

connection with any criminal investigations or proceedings involving Hantges. Diamond McCarthy and various governmental authorities are now taking steps to follow up with Milanowski regarding such cooperation obligations.

Milanowski entered into a plea agreement with the United States in a criminal case pending in Las Vegas, No. 2:07-CR-00291. He was scheduled to be sentenced on January 15, 2010, but the sentencing was continued to April 9, 2010 by the presiding Judge. Milanowski's plea agreement was accepted by the Court, and Milanowski was sentenced to 12 years of incarceration, five years of supervised release after incarceration; and, as an additional condition of his sentence, was ordered to continue to cooperate with the bankruptcy trustees and counsel in the prosecution of the remaining litigation matters. Failure to cooperate would be deemed a violation of his supervised release and would subject him to imprisonment *in addition* to the 12-year sentence. Milanowski reported to the Safford, Arizona, prison on August 6, 2010 to begin his sentence. In addition, Milanowski was also required to pay restitution totaling \$86,900,000. If you are entitled to restitution from Milanowski, by now you would have received documentation from the US District Court. DTDF is not involved in this case, and all inquiries should be directed to the US District Court in the District of Nevada regarding this matter. For your reference, the case number is 09-cr-291-RLH-PAL.

## **5. STATUS OF OTHER RECOVERY SOURCES**

### **1. Colt Loans**

DTDF and the two other direct lenders ("Colt Lenders") who are DTDF's co-beneficiaries of a promissory note secured by a first trust deed on certain parcels and buildings comprising a portion of the overall Colt project have, through Connecticut counsel hired by the three, initiated a foreclosure action. The case is working its way through the Connecticut courts.

American Tax Funding purchased tax liens on the Colt project and has filed a tax lien foreclosure complaint. Prior to American Tax Funding foreclosing on the property, the Colt Lenders have the option to cure the amount owed to American Tax Funding. Counsel for the Colt Lenders is monitoring the tax lien foreclosure action. In addition, the Colt Lenders filed a motion for the appointment of a receiver to collect and disburse rents from billboards on the Colt property. On December 14, 2010, in lieu of the appointment of a receiver of rents Colt agreed to only expend or recoup expenditures for property protection items and any remaining fund would be paid to the City of Hartford for taxes.

### **2. Loans Serviced By Compass/Silar**

Compass was the servicer of nine DTDF loans. Silar Advisors, LLC, represents that Silar foreclosed on its loan to Compass on September 26, 2008, and that Asset Resolution, LLC was an entity created to continue the servicing process. Asset Resolution LLC filed bankruptcy on October 14, 2009.

Direct lenders sought relief from the stay in the Asset Resolution LLC chapter 11 case to prosecute actions pending in the district court and sought withdrawal of the reference to the district court. A request to convert the case to chapter 7 (liquidation) or alternative request for appointment of a trustee was also filed. After a January 19, 2010 hearing, the United States District Court withdrew the reference of the Asset Resolution LLC case to the district court, under Judge Jones. Judge Jones converted the case to one under chapter 7 retroactively to January 19, 2010, and William A. Leonard, Jr. was appointed trustee.

In June 2010, the U.S. District Court signed orders authorizing the servicing transfer from Asset Resolution LLC to Cross Fractional Lending Solutions (“Cross FLS”) for 22 loans. As a result of the servicing transfer, Cross FLS is now servicing five DTDF loans (Amesbury/Hatters Point, HFA – Clear Lake, Lake Helen Partners, Mountain House Business Park and Oak Shores II). Cross FLS has prepared Asset Summary Reports and held conference calls for each of the loans and is working to collect on the loans.

## **6. DISTRIBUTIONS TO DTDF INVESTORS**

To date, three distributions (December 2007, February 2009 and December 2009) have been made for a total of \$20 million which equates to a 13.4% return of your investment based on your balance at the time of the DTDF bankruptcy filing. While DTDF does not know the timing and/or amount of future distributions, as a result of the recovery efforts mentioned above, additional monies should be available to distribute in the future.

Please keep DTDF informed of your current address. DTDF will not mail distribution checks to those investors for which mail has been returned and no forwarding address has been provided.

## **7. COMMUNICATIONS WITH DTDF INVESTORS**

I am pleased to receive your phone calls and to answer questions about our status to the best of my ability. My personal cell phone number is (702) 239-4222 or you may send us inquiries at [diversifiedfund@orrick.com](mailto:diversifiedfund@orrick.com).

For address changes, please print and complete the Change of Address form posted on the DTDF website (form can be found under 1. Updates/Questions) or send a written request with your legal vesting name and account number to DTDF at the following address:

USA Capital Diversified Trust Deed Fund  
C/O FTI Consulting, Inc.  
Two North Central Avenue, Suite 1200  
Phoenix, Arizona 85004

The website provides updates on recent developments and every letter to DTDF investors, including this one, is posted there. To access the DTDF Website type <http://usacapdtfd.bmcgroup.com/default.aspx> into the browser.

### **Conclusion**

We understand your desire to receive additional distributions, and are doing our best to expedite the recovery efforts. DTDF has every intention of making one or more distributions in the future, but at this time, we cannot estimate the timing or the amount of the next distribution. Please know DTDF continues to focus on the recovery of assets and the prosecution of causes of action against potential recovery targets. We continue to ask for your patience, and want to assure you that the Board and the DTDF professionals are giving our best efforts to obtain the best possible recovery for you.

Best Regards,  
Robert G. Worthen  
Chairman of the Board