

# USA CAPITAL DIVERSIFIED TRUST DEED FUND, LLC

Robert G. Worthen, Chairman of the Board

August 25, 2008

Dear USA Capital Diversified Trust Deed Fund, LLC Investor:

I again write on behalf of the Board of Directors of USA Capital Diversified Trust Deed Fund, LLC (“DTDF”) to update you regarding DTDF’s efforts to collect assets and to make distributions to investors. As described in more detail below, we continue to focus on recovering assets and the investigation and prosecution of causes of action against potential recovery targets. DTDF is striving to make a distribution by year-end and will be able to do so if a few expected recoveries are in fact paid to DTDF.

In previous letters to investors – each of which is posted on the DTDF website – we reported to you on our efforts to recover assets. This letter builds off of the information provided in the previous letters and covers the following topics:

1. Settlement with USA Commercial Mortgage Trust (“USACM”) – Settlement between DTDF and USACM regarding DTDF’s unsecured claim in USACM’s estate, joint pursuit of litigation and other matters.
2. Investigating and Prosecuting Causes of Action against Potential Target Defendants – Summary of litigation plan and list of lawsuits filed by DTDF.
3. Advocating DTDF Interests in Other Bankruptcy Cases – Summary of bankruptcy cases and DTDF’s involvement and claim amounts.
4. Preserving Assets of Insiders (Thomas Hantges and Joseph Milanowski) – Summary of bankruptcy filings, DTDF’s involvement and claim amounts and other lawsuits.
5. Status of Other Recovery Sources – Update on collections of the Colt loans and Compass-serviced loans.
6. DTDF Taxes – Available tax benefits for DTDF regarding bad debt, loan loss, etc. has been researched by DTDF professionals and will continue to be researched on an annual basis.
7. Communications With DTDF Members – Phone number and e-mail address provided for DTDF investor questions.
8. Accessing The DTDF Website – Website information provided for investors to access DTDF information.

After reviewing the following, you may want to re-read portions of the earlier letters for additional background information.

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

Confirmation of the Plan did not resolve numerous disputes between USACM and DTDF. In March 2008 DTDF and USACM settled their disputes.

In summary, the settlement provided:

- DTDF and USACM split certain reserves held by USACM on a 40/60 basis;
- DTDF is allowed a \$128 million unsecured claim in the USACM Estate;
- DTDF hires Diamond McCarthy LLP to pursue certain DTDF Litigation Claims, that will generally be prosecuted jointly with similar claims asserted by USACM through Diamond McCarthy;
- DTDF and USACM will jointly share proceeds of litigation claims, including those DTDF Litigation Claims prosecuted by Diamond McCarthy, with DTDF receiving 50% of the first \$20 million of gross recoveries, and DTDF receiving 35% of all gross recoveries thereafter;
- DTDF, by reason of its allowed general unsecured claim, will share in the USACM recoveries from both litigation claims and other assets of USACM on a pro-rata basis with all other allowed general unsecured creditor claims;
- DTDF and USACM share proceeds of the \$58 million note made by USA Investment Partners (“USAIP”) on an equal basis; and
- DTDF and USACM release each other of potential claims.

The compromise was the subject of notice to those parties entitled to post-confirmation notice and considered at a hearing on March 25, 2008. The Bankruptcy Court asked that additional notice be provided and that the deadline for objections be extended to March 31, 2008. No objections were received and on April 1, 2008, the bankruptcy court entered its Order Granting Motion to Approve Settlement Agreement with USA Capital Diversified Trust Deed Fund, LLC. Reserves of approximately \$5 million were released by USACM – 60% to USACM and 40% to DTDF. DTDF engaged Diamond McCarthy as its special counsel and Diamond McCarthy filed causes of action on behalf of DTDF before the expiration of the two-year tolling period on April 13, 2008.

The DTDF professionals and the Board are pleased with the settlement reached with USACM. Pursuing the litigation claims jointly allows DTDF to share in USACM claim recoveries from litigation targets that DTDF may not have pursued and vica versa for USACM. The settlement also allows DTDF to pursue its litigation targets without incurring substantial professional fees. Having an agreement with USACM eliminates future controversy regarding the allocation of claim recoveries and allows DTDF to receive proceeds from USACM litigation recoveries on a real time basis rather than waiting for USACM to make a distribution to its creditors. Finally, the settlement will serve to reduce DTDF’s ongoing attorney’s fees as the role of Orrick and Snell & Wilmer will be greatly reduced.

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

Diamond McCarthy as special litigation counsel has actively conducted formal and informal discovery of files, witnesses and transactions since its informal engagement by USACM in January 2007, which was formalized once the plan went effective in March 2007. The goals are to develop and then prosecute causes of action against insiders and third parties to recover damages for the benefit of DTDF investors and USACM creditors. In addition, special litigation counsel has sought to identify assets diverted by insiders and their affiliates so that the assets can be recovered. Diamond McCarthy is coordinating those efforts with others, including the USAIP Trustee, and the Trustees for Hantges and Milanowski mentioned below. Dozens of witnesses have been deposed or interviewed, and many thousands of documents have been reviewed. Further, Diamond McCarthy is coordinating efforts with various federal and state Governmental agencies, including the FBI, US Attorney's Office for Las Vegas, and the SEC.

DTDF and USACM had the benefit of a two-year tolling period under Bankruptcy Code § 108 to bring many claims and causes of action owned by DTDF and USACM on the date of its bankruptcy filing. The two-year anniversary of the bankruptcy filing was April 13, 2008. DTDF and USACM filed numerous causes of action before this deadline. Lawsuits where DTDF is a plaintiff were filed against the following in United States Bankruptcy Court for the District of Nevada:

<b>Case No.</b>	<b>Defendant</b>
08-01132	Stanley E. Fulton <sup>1</sup>
08-01133	Kathryn L. Petersen; Kathryn L. Petersen Living Trust; KLP Trust dated 7/15/99; Specialized Development Tahoe, LLC <sup>2</sup>
08-01134	Mary Petersen; Mary Petersen Family Trust dated 8/12/98; Michael D. Petersen; Michael D. Petersen Family Trust dated 8/12/98; Kathryn L. Petersen; Kathryn L. Petersen Living Trust; KLP Trust dated 7/15/99 <sup>3</sup>
08-01135	Wells Fargo Bank, N.A. <sup>4</sup>
08-01164	Beadle, McBride, Evans & Reeves, LLP; Reeves, Evans, McBride & Zhang, LLP; TG McBride, CPA Ltd.; T. Garth McBride <sup>5</sup>
08-0112-0	David A. Fogg <sup>6</sup>

<sup>1</sup> Plaintiff is DTDF.

<sup>2</sup> Plaintiff is DTDF.

<sup>3</sup> Plaintiffs are USACM and DTDF.

<sup>4</sup> Plaintiffs are USACM, DTDF and FTDF.

<sup>5</sup> Plaintiffs are USACM and DTDF.

<sup>6</sup> Plaintiffs are USACM and DTDF.

Additionally, a complaint was filed in the United States District Court for the District of Nevada, as follows:

<b>Case No.</b>	<b>Plaintiffs</b>	<b>Defendants</b>
2:08-CV-461	USACM and DTDF	Deloitte & Touche, LLP; Victoria Loob

These actions are being prosecuted in order to recover funds for DTDF investors and USACM beneficiaries.

DTDF and USACM also entered into what are known as “tolling agreements” with a number of potential targets before the deadline for bringing action. In essence, a tolling agreement allows DTDF and USACM to take more time to investigate possible causes of action and hopefully negotiate settlement of any claims against the potential targets before filing suit. The relevant limitations period is tolled during the pendency of the tolling agreement. For confidentiality and other reasons, to encourage settlement and to protect potential targets about whom DTDF and USACM may not have sufficient information to bring an action at this time, DTDF and USACM are not disclosing the identity of the persons and entities with whom they have entered into tolling agreements except for a few such agreements filed with the Court.

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

#### **USAIP Chapter 11 Case**

DTDF and USACM joined with other creditors of USAIP in the filing of an involuntary chapter 11 petition against USAIP in early April 2007. As a result, USAIP is a debtor in a bankruptcy case pending in Nevada (case #07-11821-LBR). USAIP is the maker of a \$58,374,918.81 promissory note (the “\$58 Million Note”) to USACM for the benefit of creditors (including DTDF). Repayment of the \$58 Million Note and other obligations of USAIP are secured by liens on USAIP’s interest in entities owned or in part by USAIP.<sup>7</sup> As mentioned above, DTDF and USACM will share collections on the \$58 Million Note on an equal basis.

#### **Trustee**

Over the objection of Hantges and Milanowski, through their counsel, the bankruptcy court (Honorable Linda B. Riegler) entered an order directing the United States Trustee to appoint a trustee for USAIP. Lisa M. Poulin was appointed as trustee. She selected Gordon & Silver, P.C. of Las Vegas, Nevada as her counsel, with the Court’s approval.

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<sup>7</sup> Capital Land Investors, LLC, a California limited liability company; Ashby USA, LLC, a California limited liability company; Placer County Land Investors, LLC a California limited liability company (f/k/a Placer County Land Speculators, LLC); Oak Mesa Investors, LLC, a California limited liability company; HMA Sales, LLC, a Nevada limited liability company; Tanamera Properties, LLC; Random Developments, LLC, a California limited liability company; and Buffalo Land Developments, LLC, a California limited liability company.

### Proofs of Claim

DTDF timely filed a proof of claim seeking \$176,380,998 from the USAIP estate. Resolution of claims against the USAIP estate and the possibility of payment are months or years away.

As Lisa Poulin identified USAIP subsidiaries in need of bankruptcy protection, bankruptcy cases were filed, she was appointed trustee, and the cases were jointly administered. These include: HMA Sales, LLC, Case No. 07-12694; Capital Land Investors, LLC, Case No. 07-18099; Oak Mesa Investors, LLC, Case No. 08-10397; and Buffalo Land Development Co., LLC, Case No. 08-10398.

### **Tree Moss Partners, LLC Chapter 11 Case**

Tree Moss Partners, LLC (“Tree Moss”) is a debtor in bankruptcy due to an involuntary bankruptcy petition (Case No. 06-13758-LBR) filed by DTDF. Ms. Poulin has been appointed trustee for Tree Moss. Tree Moss owns the condominium project adjacent to the Hotel Zoso. USAIP’s equity in this entity is not pledged as collateral for the \$58 Million Note.

DTDF filed a proof of unsecured claim for \$23,116,045 in the Tree Moss case.

On April 1, 2008, the Bankruptcy Court granted the Motion of the Trustee for Tree Moss for sale of substantially all of its property and releases with Diamond Resorts Corporation as buyer for approximately \$9,000,000. The sale is conditioned upon a few items one of which is the extension of the ground lease by Bureau of Indian Affairs. The buyer is expected to negotiate and finalize the ground lease with Bureau of Indian Affairs by November 2008.

### **USA Investors VI, LLC Chapter 11 Case**

USA Investors VI, LLC (“Investors VI”) is a debtor in bankruptcy due to an involuntary bankruptcy petition (Case No. 07-12377-lbr) filed by DTDF. Ms. Poulin has been appointed trustee for Investors VI. The sole asset of Investors VI was the Hotel Zoso in Palm Springs that was sold in late 2007 with the lion's share of the proceeds paid to the secured lender.

DTDF filed a proof of unsecured claim for \$13,310,422 in the Investors VI case. Unfortunately, it appears the available funds for distribution to unsecured creditors will be minimal.

### **HMA Sales, LLC Chapter 11 Case**

HMA Sales is a debtor in bankruptcy due to a voluntary chapter 11 petition (Case No 07-12694) filed by USAIP under the control of Ms. Poulin. Ms. Poulin is the trustee for HMA Sales. DTDF and HMA Sales reached a settlement agreement in June 2007 that was discussed in prior letters to investors. As a result of the settlement agreement DTDF received \$8.9MM in 2007 and will receive additional monies in 2008 and possibly 2009. DTDF continues to monitor the HMA Sales bankruptcy and work with Ms. Poulin and her counsel to collect additional sums relating to the Royal Hotel.

### **BySynergy, LLC Chapter 11 Case**

BySynergy is also a debtor in bankruptcy due to an involuntary bankruptcy petition (Case No. 08-7680-rtb) filed by parties other than DTDF on June 25, 2008. DTDF is monitoring the bankruptcy case to determine what amounts, if any, will become available for distribution to DTDF on account of BySynergy's loan from DTDF.

#### **4. Preserving Assets of Insiders (Thomas Hantges and Joseph Milanowski)**

##### Thomas Hantges ("Hantges")

Due to the filing of an involuntary bankruptcy petition by DTDF, USACM and other creditors, Hantges is a debtor in a chapter 11 bankruptcy case in Nevada, Case No. 07-13163-lbr. Michael Carmel was appointed trustee in the Hantges bankruptcy.

DTDF timely filed a proof of claim against the estate of Hantges seeking the amount of \$182,538,254. Resolution of claims against the Hantges estate and the possibility of payment are months or years away.

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

The Hantges trustee objected to the exempt assets claimed by Hantges and prosecuted a complaint to recover funds transferred by Hantges to a family trust, Adversary No. 08-01002 pending in the bankruptcy court. The action includes other defendants who were sued for aiding fraudulent transfers and concealment of assets.

On May 7, 2008, Hantges filed a motion to dismiss his chapter 11 case or an alternative motion to convert the case from chapter 11 to chapter 7. Hantges argued that prosecution of the case in chapter 11 was not in the best interests of creditors, and that a requirement of bankruptcy law applicable to individual chapter 11 bankruptcy cases could effectively impose unconstitutional involuntary servitude upon Hantges. Each of the Hantges trustee, USACM and the Office of the United States Trustee have filed papers opposing Hantges' motion. That motion is set for hearing before the bankruptcy court on August 26, 2008.

##### Joseph Milanowski ("Milanowski")

Similarly, due to the filing of an involuntary bankruptcy petition by DTDF, USACM and other creditors, Milanowski is a debtor in a chapter 11 bankruptcy case in Nevada, Case No. 07-13162-lbr. Although Milanowski and his counsel strenuously opposed the involuntary, the Bankruptcy Court entered an order for relief against Milanowski and appointed Ford Elsaesser as the trustee. Milanowski has appealed the order for relief. The Milanowski appeal is in the United States District Court for the District of Nevada, Case No. 3:07-cv-404. This appeal was reassigned to Judge Brian E. Sandoval and eventually dismissed, on May 8, 2008.

DTDF filed a proof of claim against Milanowski for \$182,538,254. Resolution of claims against the Milanowski estate and the possibility of payment are months or years away.

DTDF filed a complaint in the bankruptcy court, Adv. No. 07-13162-lbr, to determine the non-dischargeability of Milanowski's debts to DTDF. That complaint is in the early stages of discovery. A scheduling conference is set for August 27, 2008. Similar lawsuits were filed against Milanowski by USACM (No. 08-01093), Aurora Investment L.P (No. 07-01212), the Kehl family (No. 08-01052), the PBGC (No. 08-01044), and BySynergy, LLC (No. 07-01209).

On April 23, 2008, the SEC brought an action against Milanowski "in connection with a multi-million dollar fraud" seeking an order requiring Milanowski to disgorge sums obtained. The complaint was filed with the United States District for the District of Nevada and is Case No. 2:08-CV-00511. Milanowski filed an Answer to the complaint on June 27, 2008 and a discovery plan/scheduling order is due in August.

## **5. Status of Other Recovery Sources**

### Colt Loans

DTDF and the two other direct 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, but justice moves slowly, and foreclosure is not on the near horizon.

### Loans Serviced By Compass

Compass is the servicer of nine DTDF loans. As of July 31, 2008, the total outstanding amount due to DTDF for the nine loans approximated \$7.0 million. The two largest DTDF loans serviced by Compass are the Amesbury/Hatters Point loan with \$3.8 million owed to DTDF and the Ten-Ninety, Ltd loan with \$1.5 million owed to DTDF.

Compass provides monthly loan status updates for each loan on its website at <http://www.compassloans.net/currentloans> . Provided below is a brief summary of the collection status for each of DTDF's loans serviced by Compass:

1. Amesbury/Hatters Point – Compass is moving forward with receiving the Deed in Lieu of Foreclosure or foreclosing on the remaining collateral. The borrower's guarantee appears to be worthless and Compass is currently going through the due diligence to substantiate that.
2. Bay Pompano Beach – A discounted payoff offer has been accepted that would pay the direct lenders approximately 77% of the principal and non-default interest owed. DTDF holds a .47% interest in this loan and is owed approximately \$82,000. The discounted payoff is expected to close in the near future, if that occurs DTDF would receive approximately \$63,000.
3. HFA – Clear Lake – Negotiations by Compass with the borrower have been ongoing, but have not produced viable loan resolution. Compass will proceed to foreclose on the collateral.
4. Huntsville – Compass has foreclosed on the collateral and is in negotiations with potential buyers of the property.

5. Lake Helen Partners – The borrower contested the foreclosure. Compass prevailed on a Motion for Summary Judgment, defeating the borrower’s defenses. At the same hearing, the Direct Lenders and Compass were awarded a Final Judgment of Foreclosure.
6. Mountain House Business Park – The borrower filed Chapter 11 bankruptcy in late February to stay the foreclosures. Compass is monitoring the chapter 11 bankruptcy case and participating in the Chapter 11 process.
7. Oak Shores II – Compass is investigating whether to pursue judicial or non-judicial foreclosure.
8. Ten-Ninety, Ltd – Compass foreclosed on the collateral and is marketing the sale of the asset through O’Donnell Atkins.
9. The Gardens, LLC Timeshare – DTDF sold its interest (5.43%) in The Gardens loan to a third party in July 2008 for 75% of the principal balance or \$146k.

Compass and the Lender Protection Group have various disputes between each other, primarily with respect to the servicing rights of the direct lender loans. DTDF is not directly involved in those disputes.

## **6. DTDF Taxes**

KPMG prepared DTDF’s 2006 and 2007 tax returns. KPMG and other DTDF professionals have researched tax provisions and made appropriate adjustments regarding the treatment of bad debt, loan loss and loss due to fraudulent activity to realize available tax benefits. In certain situations DTDF may be able to realize available tax benefits once a final determination of non-collectability can be made on individual DTDF assets. DTDF will continue to investigate available tax benefits and make appropriate adjustments on an annual basis.

## **7. Communications With DTDF Members**

We will send you another letter within the next three months. As it is very expensive to communicate with our professionals, who bill hourly fees, 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.

Also, you may send us inquiries at [diversifiedfund@orrick.com](mailto:diversifiedfund@orrick.com). For address changes, please 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

## **8. Accessing The DTDF Website**

The website provides a convenient way to track the progress in this case. There, you can view an updated court docket, with links to recent pleadings and informative updates. Every letter to DTDF investors, including this one, is posted on the website. I urge you to visit our website on a regular basis. Here are two ways to access the DTDF Website:

- TYPING: Type <http://usacapdtdf.bmcgroup.com/default.aspx> into the browser screen at the top of your monitor.
- GOOGLE: If you type “USA Capital Diversified Information” in Google, the first resulting link should be the DTDF Website. Simply click on the link and you will be at the DTDF Website.

### **Conclusion**

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 recovery for you.

Best Regards,  
Robert G. Worthen  
Chairman of the Board