

**UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK**

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

- against -

STEVEN BYERS, JOSEPH SHERESHEVSKY,  
WEXTRUST CAPITAL, LLC, WEXTRUST  
EQUITY PARTNERS, LLC, WEXTRUST  
DEVELOPMENT GROUP, LLC, WEXTRUST  
SECURITIES, LLC, and AXELA HOSPITALITY,  
LLC,

Defendants,

- and -

ELKA SHERESHEVSKY,

Relief Defendant.

No. 08 Civ. 7104 (DC)

ECF Case

**DECLARATION OF JOHN K. WARREN IN SUPPORT OF RECEIVER'S  
RESPONSE TO THE COURT'S ORDER OF AUGUST 19, 2009 OUTLINING  
ACTIVE CLAIMS DISPUTES RELATED TO THE PLAN OF DISTRIBUTION**

I, John K. Warren, under penalty of perjury declare as follows:

1. I am an attorney admitted to practice in the District of Columbia and the Commonwealth of Virginia and admitted *pro hac vice* in this matter.
2. I am an associate at the law firm of Dewey & LeBoeuf LLP, legal advisors to Timothy J. Coleman, duly appointed receiver ("Receiver") for the Defendant Wextrust Entities and all entities they control or in which they have an ownership interest (collectively, the "Wextrust Entities and Affiliates"). I am resident in the Washington, D.C. office.
3. I submit this declaration in support of the Receiver's Response to the Court's Order of August 19, 2009 Outlining Active Claims Disputes Related to the Plan of Distribution.

This submission is intended to supplement the documentary evidence provided to the Court on Monday, September 14, 2009.

4. Attached hereto as **Exhibit A** is a true and correct copy of a letter dated September 11, 2009 from Mr. Guy Morris to the Receiver withdrawing claims asserted by 56 Walker, LLC.

5. Attached hereto as **Exhibit B** is a true and correct copy of a letter dated September 7, 2009 from Ronan Guilfoyle regarding certain claims related to the Wextrust High Yield Debt Offshore Fund, Ltd.

6. Attached hereto as **Exhibit C** is a true and correct copy of a letter dated September 10, 2009 from counsel to The Broadway Bank to counsel for the Receiver.

Dated: September 14, 2009

Respectfully Submitted,

s/ John K. Warren

John K. Warren, *pro hac vice*  
Dewey & LeBoeuf LLP  
1101 New York Avenue, NW  
Washington, D.C. 20005-4213  
Tel: (202) 346-8000  
Fax: (202) 346-8102

*Attorneys for the Receiver*

# EXHIBIT A

# **56 WALKER, LLC**

**56 Walker Street  
New York, NY 10013**

September 11, 2009

Hon. Timothy J. Coleman  
Receiver  
Wextrust Capital LLC  
c/o Dewey LeBoef  
1101 New York Ave.  
Washington, DC 20005

Via email:  
Wextrustreceiver@dl.com  
wextrustinvoice@dl.com  
mkhambati@dl.com

**Re: Withdrawal of Wextrust Creditor Claim of 56 Walker, LLC**

Dear Receiver Coleman:

I am writing on behalf of 56 Walker, LLC, which previously filed a creditor claim with your office. Recently, 56 Walker, LLC was sued in New York Supreme Court, New York County, by Broadway Bank to foreclose on a mortgage. There are a number of other defendants in that lawsuit, including Wexford/HPC Mortgage Fund LP. 56 Walker, LLC has brought a third-party action against HPC Management LLC. I am informed that full discovery proceedings will shortly be scheduled and some discovery has already occurred.

Accordingly, Claimant 56 Walker, LLC finds it necessary to withdraw its claim in the receivership proceeding, which was previously submitted to you, and said claim is hereby withdrawn. If necessary, please so inform the court.

This withdrawal is without prejudice to the rights of 56 Walker, LLC in the state court litigation or any other proceeding.

Very truly yours,

*Guy Morris*

Guy Morris

CC: Hon. Denny Chin  
Daniel Patrick Moynihan  
US District Courthouse  
500 Pearl Street  
New York, NY 10007

# EXHIBIT B

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Wextrust High Yield Debt Offshore Fund, Limited  
C/o Appleby Trust (Cayman) Limited  
75 Fort Street, Clifton House  
Grand Cayman KY1-1108  
Cayman Islands

7 September 2009

Dear Sirs

**Re: WexTrust High Yield Debt Offshore Fund Limited (the "Offshore Fund")**

We refer to your letter to dms dated 14 August 2009 (a copy of which is attached) and to your determination that a claim for the provision of director services to the Offshore Fund does not constitute a valid claim in the WexTrust Receivership. It appears to us that two issues arise by reason of your rejection of the dms claim. First, do you intend to treat all Offshore Fund assets as assets in the Receivership Estate and secondly, if so, how do you intend to treat Offshore Fund Investors' claims.

In your letter of 30 September 2008 (a copy of which is also attached) Mr Cotner of your office sets out the nature and scope of the Offshore Fund's investments. The order appointing Mr Coleman as Receiver of WexTrust entities, which order was dated 11 August 2008, lists the Offshore Fund in Exhibit A. By your letter of 30 September 2008 you advised variously that *"the Receiver recognises his responsibility to protect and preserve the assets of all WexTrust Investors"* and further, that HPC US Fund 1 assumed the role of General Partner and Loan Servicer for the WexTrust HPC Mortgage Fund LP and that *"it should be noted that HPC appraises the Receiver, day to day of all decisions and events concerning the WexTrust/HPC Mortgage Fund"*. It has been the Receiver's position that he is Receiver of the Offshore Fund. Will you please advise if this position has now changed.

The Receiver has now determined that the dms claim is against WexTrust/HPC Mortgage Fund, LP. Please advise if all of the Offshore Fund investors will be treated in the same way (i.e. that the Receiver considers that the Offshore Fund's investors' claims are also against Wextrust/HPC Mortgage Fund, LP). Further, would the Receiver please advise if he considers the assets of the Offshore Fund, (i.e. participation notes in loans purchased from WexTrust/HPC Mortgage Fund LP) form assets of the WexTrust Receivership estate.

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We look forward to your reply as a matter of urgency.

Yours faithfully

A handwritten signature in black ink, appearing to be 'Ronan Guilfoyle', written in a cursive style.

Ronan Guilfoyle, Director

cc: James Cotner, Moshin Khambati

# DEWEY & LEBOEUF

Dewey & LeBoeuf LLP  
1101 New York Avenue, NW  
Suite 1100  
Washington, DC 20005-4213

tel +1 202 346 8030  
fax +1 202 956 3266  
jcotner@dl.com

September 30, 2008

Jeremy Walton  
Appleby  
Clifton House  
75 Fort Street  
PO Box 190  
Grand Cayman KY1-1104  
Cayman Islands

Re: WexTrust High Yield Debt Offshore Fund, Ltd.

Dear Mr. Walton:

We refer to your letters of August 25 and September 11, 2008, as well to conversations held between Callum McNeil and yourself of Appleby and Mohsin Khambati and myself, regarding the location and status of assets held by the WexTrust High Yield Debt Offshore Fund ("Offshore Fund"). As we have discussed, Timothy J. Coleman, has been appointed Receiver by the U.S. District Court for the Southern District of New York for the Defendant WexTrust Entities in *SEC v. Byers, et al.*, and all entities they control or in which they have an ownership interest, including, but not limited to, those listed in Exhibit A to the Order Appointing Temporary Receiver (Aug. 11, 2008), which lists the Offshore Fund.

The Receiver appreciates that the investors in the Offshore Fund are concerned with the preservation and protection of the Offshore Fund's assets. As you note, the assets of the Offshore Fund are participation interests in loans to be repaid by borrowers, and investors in the Fund would be concerned rightfully if the appointment of the Receiver lead to dissipation of assets or a weakening in the loan portfolio. The Receiver recognizes these concerns and he is actively evaluating how best to protect the interests of all of the Fund's investors as he pursues obligations and assets owed to the WexTrust Entities. Indeed, as set forth below, notwithstanding the appointment of the Receiver, substantially all of the loans in the Offshore Fund continue to be serviced by HPC Capital, which was appointed as General Partner and Servicer of Wextrust/HPC Mortgage Fund, LP even prior to the appointment of the Receiver and remains an active and majority participant in almost all of the loans relating to the Offshore

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Fund. In short, the appointment of the Receiver itself has not precipitated any detrimental changes to the portfolio.

As noted in the Receiver's Letter to Investors of September 11, 2008, a copy of which is attached hereto, the Court has ordered the Receiver to perform the following functions with respect to the WexTrust Entities:

- (1) preserve the *status quo*; (2) ascertain the true financial condition of the WexTrust Entities; (3) determine the extent of commingling of funds between the WexTrust Entities and related entities; (4) prevent further dissipation of property and assets; (5) prevent the encumbrance or disposal of property and assets; (6) preserve the books, records and documents of the WexTrust Entities and related entities; (7) be available to respond to investor inquiries; and (8) determine if the WexTrust Entities or related entities should undertake a bankruptcy filing.<sup>1</sup>

Pursuant to this instruction, and in cooperation with the United States Securities and Exchange Commission, Department of Justice, and Federal Bureau of Investigation, the Receiver has acted to secure and begin managing all assets and properties of the Wextrust Entities in the United States and abroad.

As Receiver to all WexTrust Entities, including WexTrust Capital, LLC – investment manager to the Offshore Fund and to Wexford High Yield Debt Funds I and III (“HYD Fund I” and “HYD Fund III”) – the Receiver recognizes his responsibility to protect and preserve the assets of all WexTrust investors. As investors in the Offshore Fund are no doubt aware, the Offshore Fund's assets consist of loans purchased by the Offshore Fund that were originated by HYD Fund III or by Wextrust/HPC Mortgage Fund, LP, a joint venture fund in which HYD Fund III is a limited partner and loan participant. Almost all of the loans in which the Offshore Fund has an interest were co-funded by a partner investment company, HPC Capital GmbH, investment manager to the HPC US Funds 1 and 2.

HPC Capital, for example, has substantial positions in Wextrust/HPC Mortgage Fund, LP, and over time has funded and continues to fund several loan commitments on behalf of Wextrust/HPC Mortgage Fund, LP. On August 7, 2008, HPC US Fund 1 assumed the role of general partner and loan servicer for the Wextrust/HPC Mortgage Fund and is currently servicing the Wextrust/HPC Mortgage Fund loans. It should be noted that HPC apprises the Receiver, day to day, of all decisions and events concerning the Wextrust/HPC Mortgage Fund.

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<sup>1</sup> The order appointing Timothy J. Coleman as Temporary Receiver and other court documents are available on the Receivership website (<http://www.WexTrustreceiver.com>).

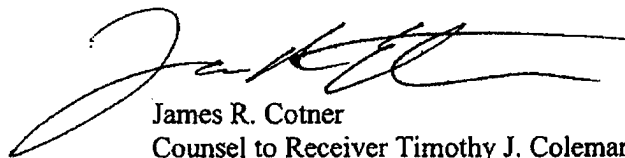
To best preserve the assets of all WexTrust entities, the Receiver has retained expert advisors including Deloitte Financial Advisory Services LLP and The Hilco Organization, a leading asset valuation and disposition firm based in the Chicago area. Hilco, for example, is an expert on real estate assets and is advising the Receiver on matters including, but not limited to, the non-performance of loans held within the Offshore Fund portfolio, which are collateralized by real property. In addition, the Receiver is coordinating with HPC to ensure the continued and proper servicing of the jointly funded loans. In short, the Receiver is committed to preserving and maximizing value of the assets of HYD Fund III and the HYD Offshore Fund, and is working with existing management and retained professionals to oversee the same.

The Receiver is dedicated to responding to all inquiries from WexTrust investors and has established a dedicated investor relations team which, to date, has been in contact with more than 700 investors located in the United States, Israel, and other countries. As noted in your letter of September 11, the Receiver has met in person with many WexTrust investors, including at "town hall" meetings in Chicago, New York, Norfolk, and Tel Aviv. Unfortunately, adequate notice may not have been provided to the Offshore Fund of these meetings. Future communications to investors from the Receiver and notices regarding upcoming investor meetings will be communicated directly to counsel for the Offshore Fund by the Receiver's investor relations team. Any investors in the Offshore Fund who wish to be alerted individually of such notices may provide their contact information to the investor relations team by e-mailing [wextrustreceiver@dl.com](mailto:wextrustreceiver@dl.com) or calling 1-888-518-2410.

Furthermore, as we indicated on our call, counsel to and investors in the Offshore Fund should not hesitate to contact specific individuals at WexTrust or Dewey & LeBoeuf with any questions or concerns regarding the Offshore Fund. Ms. Perrine Knight, Vice President of Operations at WexTrust Capital, is highly knowledgeable of the status and performance of WexTrust's funds, including overseeing the High Yield Debt Offshore Fund. Ms. Knight may be reached at (312) 423-3947. In addition, counsel and investors may contact Dewey & LeBoeuf's Mohsin Khambati or James Cotner, who are advising the Receiver on various matters, including the High Yield Debt Offshore Fund. They may be reached at (312) 794-8052 or (202) 346-8030, respectively.

In our previous communications, counsel has expressed concern regarding the legal effect of the U.S. District Court's Orders in the Cayman Islands and has recommended that the Receiver file an application to be recognized in the Caymans. Please note that the Receiver is considering this option. As offered during our conversation, we would appreciate any further discussions, assistance and advice from the Appleby firm in this undertaking.

Sincerely,



James R. Cotner  
Counsel to Receiver Timothy J. Coleman

Encls. (1) Receiver Timothy J. Coleman Letter to WexTrust Investors (Sept. 11, 2008)  
(2) Amended Order Appointing Temporary Receiver (Sept. 11, 2008)

# DEWEY & LeBOEUF

Dewey & LeBoeuf LLP  
1101 New York Avenue, NW  
Washington, DC 20005-4213

tel: 1-888-518-2410  
fax: 1-202-956-3279  
email: [wextrustreceiver@dl.com](mailto:wextrustreceiver@dl.com)

August 14, 2009

**VIA ELECTRONIC AND FIRST CLASS MAIL**

DMS Management  
P.O. Box 31910  
Grand Cayman KY1-1208  
Cayman Islands

**Re: Invalid Wextrust Receivership Claim**

Dear Creditor:

We write on behalf of Timothy J. Coleman, Receiver to the Wextrust Entities and Affiliates, appointed in *SEC v. Byers*, case number 08-7104, currently pending in the United States District Court for the Southern District of New York (the "Court").

The Receiver and his professional advisers have determined that your claim is against Wexford/HPC Mortgage Fund, L.P. ("Wex/HPC"), and not against the Wextrust receivership estate. Wex/HPC is a joint venture in which the receivership holds a partnership interest. HPC US Fund I, L.P. ("HPC"), an entity neither within the receivership estate nor under the control of the Receiver, serves as the General Partner of Wex/HPC. Wex/HPC is neither managed nor operated by the Receiver, but rather by HPC.

Accordingly, you must look to satisfy your claim against Wex/HPC, and not against the Wextrust receivership estate. For this reason, your claim against the Wextrust receivership estate is **denied**.

You have a right to challenge the Receiver's determination and treatment of your claim. **If you wish to dispute the Receiver's determination and treatment of your claim as invalid, please inform us of your decision and your reason for doing so by Friday, August 21, 2009.** Please also include any supporting evidence with your response. If we are unable to amicably resolve your dispute by **August 24, 2009**, we will provide your name to the Court so that the Court may set a hearing to intervene and resolve the matter. If we do not receive a response from you by **August 21, 2009**, we will assume that you do not dispute the Receiver's determination of your claim.

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August 14, 2009

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**Please send your response to us in writing at:**

Wextrust Investor Relations  
c/o Dewey & LeBoeuf, LLP  
1101 New York Avenue, NW  
Washington D.C. 20005-4213

**Or via email at:**

[WextrustInvoice@dl.com](mailto:WextrustInvoice@dl.com) and [mkhambati@dl.com](mailto:mkhambati@dl.com)

**Or via facsimile at:**

1-202-956-3279  
Attn: Wextrust Investor Relations

**Please send all inquiries and communications concerning this matter to**  
[WextrustReceiver@dl.com](mailto:WextrustReceiver@dl.com), or call 1-888-518-2410.

Sincerely,

Dewey & LeBoeuf LLP

*Counsel to the Receiver*

# EXHIBIT C

# BUDD LARNER

A PROFESSIONAL CORPORATION  
COUNSELLORS AT LAW

150 JOHN F. KENNEDY PARKWAY  
SHORT HILLS, NJ 07078-2703  
973.379.4800  
FAX 973.379.7734  
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Direct Dial (973) 315-4424

September 10, 2009

## BY E-MAIL

Mohsin N. Khambati, Esq.  
Dewey & LeBoeuf, LLP  
Two Prudential Plaza  
180 North Stetson Avenue, Suite 3700  
Chicago, IL 60601

Re: The Broadway Bank v. HPC US Fund I, L.P. et al.  
Docket No. ATL-C-73-09

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Dear Mr. Khambati:

This firm represents The Broadway Bank ("**Broadway**") in the above referenced matter. At your request (and notwithstanding counsel for HPC US Fund I, L.P., Mark Rowley, Esq.'s unsubstantiated claims in his e-mail dated September 1, 2009), this letter will demonstrate that the Participation Interest (as defined below) which Broadway sold to Wexford High Yield Debt Fund III, LP ("**High Yield**") is not subject to the Receiver's control or authority because:

(1) At the time of and prior to the Receiver's appointment, Broadway's security interest in the Participation Interest was perfected pursuant to the terms of the revised Uniform Commercial Code (the "**UCC**") by automatic perfection under UCC § 9-309 and/or by possession of the collateral by Broadway, and therefore was superior to any interest of the Receiver or any other person or entity.

(2) Even if Broadway's security interest in the Participation Interest was not so perfected, under principles of equitable subrogation the Receiver's interests will be subordinate to Broadway's interests in the Participation Interest.

(3) Even if Broadway's security interest in the Participation Interest was not perfected, Broadway entered into the September 2007 agreement with High Yield to sell its participation interest (the "**Sale Agreement**") based upon a material misrepresentation amounting to actual legal fraud. Accordingly, the Sale Agreement is voidable and Broadway is entitled to the equitable remedy of rescission. Rescission would restore High Yield to its original position, without any interest or right in the Participation Interest, and would entitle Broadway to the proceeds of the Participation Interest (i.e., an interest in the Property) in accordance with the Participation Agreement.

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Mohsin N. Khambati, Esq.  
Dewey & LeBoeuf, LLP  
September 10, 2009  
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(4) Even if Broadway's security interest in the Participation Interest was not perfected, the Receiver does not have authority to void Broadway's security interest in the Participation Interest. When a receiver is appointed, he takes all property that is subject to existing liens and equities, and the establishment of the receivership does not divest a secured creditor of its right to enforce liens against property of the estate. A receiver in a receivership action is not the same thing as a trustee in a federal bankruptcy proceeding. Whereas a receiver marshals assets for the benefit of defrauded investors subject to creditor rights that exist in state law, a trustee acts for the benefit of creditors subject to an established federal law in the Bankruptcy Code setting up priorities and procedures.

In Mr. Rowley's e-mail, he states without analysis, substance or support, that Broadway's interest in the Participation Interest is unperfected. As set forth below, Mr. Rowley's assertion is wrong. Moreover, Mr. Rowley and his clients have no interest in the outcome of any issue before the Receiver or the Court. The Receiver is therefore obligated to disregard any argument raised by either Mr. Rowley or his clients.

Please note that Broadway is also represented by Nesenoff & Miltenberg, LLP, its New York legal counsel, and that all letters (and attachments thereto) previously sent to you, your firm or the Receiver by such law firm, and the arguments set forth therein, are hereby incorporated in this letter by reference.

#### **I. Background.**

As a starting point, the basic facts are not in dispute. In May of 2007, Broadway participated in and contributed \$5,125,000.00 (the "**Bank Portion**") of a \$7,750,000 loan to Boardwalk and Lincoln, LLC ("**Boardwalk**") to acquire four parcels of real estate located in Atlantic City, New Jersey (the "**Property**"). To induce Broadway to participate in the loan, Broadway and Wextrust/HPC Mortgage Fund, L.P., f/k/a Wexford/HPC Mortgage Fund, L.P. (the "**HPC Fund**") executed a Loan Participation and Servicing Agreement (the "**Participation Agreement**") and Boardwalk executed a promissory note (the "**Boardwalk Note**") and a mortgage (the "**Boardwalk Mortgage**") in favor of both Broadway and the HPC Fund. The Participation Agreement, the Boardwalk Note, the Boardwalk Mortgage and the rights granted under each of the foregoing are hereinafter collectively referred to as the "**Participation Interest**."

In September of 2007, Broadway, with the HPC Fund's full knowledge and consent, sold its Participation Interest to High Yield. In connection with the sale, Broadway, the HPC Fund and High Yield executed an Agreement to sell the Participation Interest (the "**Sale Agreement**") and Broadway received a promissory note executed by High Yield (the "**High Yield Note**") in the amount of \$5,125,000.00 (plus accrued and unpaid interest) and a Collateral Assignment of Loan Documents executed by High Yield and Broadway (the "**Collateral Assignment**"), which assigned back to Broadway all right, title and interest in and to the Participation Interest and all



Mohsin N. Khambati, Esq.  
Dewey & LeBoeuf, LLP  
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Page 3

rights and benefits therefrom as security for the repayment and performance of the High Yield Note.<sup>1</sup>

The maturity date of the High Yield Note was extended from February 2008 to November 2008. When the High Yield Note matured, however, High Yield failed to make any payment and an event of default occurred thereunder. To date, High Yield has not repaid any of the principal balance or accrued interest which due and owing to Broadway under the High Yield Note as of the maturity date. Moreover, under the express terms of the Sale Agreement and the Collateral Assignment, High Yield, at the time it executed these documents, assigned all of its rights, title and interest in the Participation Interest to Broadway as security for payment of the High Yield Note. High Yield retained only a limited right to enjoy the benefits of the Participation Interest until the occurrence of an event of a default, and the lapse of High Yield's limited right was immediate, automatic and self-operative upon an event of default, regardless of whether Broadway enforced any of its other rights or remedies. In the Collateral Assignment, High Yield further agreed that, if an event of a default should occur, Broadway could exercise all of its rights and remedies under the Participation Interest documents without interference or objection from High Yield. Thus, as a result of High Yield's default, Broadway is entitled to exercise all of the rights and remedies in connection with any of the Participation Interest documents in this litigation.

## **II. Broadway Perfected its Secured Interest in the Participation Interest.**

At the time of and prior to the Receiver's appointment, Broadway's security interest in the Participation Interest was perfected under the UCC, and therefore was superior to any interest of the Receiver or any other person or entity.

### **a. Automatic Perfection.**

Broadway's security interest in the Participation Interest was perfected automatically when High Yield executed and delivered the Sale Agreement and Collateral Assignment because the Participation Interest constitutes a payment intangible. Under the UCC, a security interest granted in connection with the sale of a payment intangible is automatically perfected upon execution of the sale documents, without any need to file a financing statement or to take possession or control. UCC §§ 9-309(3) and 9-203(b)(3). Loan participations constitute "payment intangibles". See UCC §§ 9-102(61)(defining a payment intangible as a general intangible in which the "debtor's principal obligation is a monetary obligation"); See also Anderson, Culhane and Wilson, *Attachment and Perfection of Security Interests under Revised Article 9: A 'Nuts and Bolts' Primer*, 9 AM. BANKR. INST. L. REV. 179, 184 (2001); Dale Whitman, *Transfers of Mortgage Notes under New Article 9*, at <http://www.umkc.edu/dirt/files/newart9i.htm>.

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<sup>1</sup> To date, High Yield has not produced any instruments of conveyance, allonge, endorsement or similar document with respect to the Participation Interest, other than the Sale Agreement.

Mohsin N. Khambati, Esq.  
Dewey & LeBoeuf, LLP  
September 10, 2009  
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Moreover, Broadway's security interest in the Boardwalk Note, one of the documents constituting the Participation Interest, was perfected automatically when High Yield executed and delivered the Sale Agreement and Collateral Assignment. Under the UCC, a security interest granted in connection with the sale of a promissory note is automatically perfected upon execution of the sale documents. UCC §§ 9-309(4) and 9-203(b)(3).

Broadway's security interest in the Boardwalk Mortgage, another of the documents constituting the Participation Interest, was also perfected automatically, because the perfection of a security interest in a promissory note is also automatic perfection of a security interest in a mortgage securing such promissory note. See UCC §9-308(e).

Broadway's security interest in the Participation Agreement, a third document constituting the Participation Interest, was also perfected automatically, because the perfection of a security interest in collateral is also automatic perfection of a security interest in a supporting obligation for such collateral. See UCC §9-308(d). The Participation Agreement constitutes a "supporting obligation" for the Boardwalk note. See UCC §§ 9-102(77)(defining supporting obligation as including "a secondary obligation that supports the payment of performance of... an instrument...").

b. Perfection by Possession.

Even if a determination were to be made that there was not automatic perfection under UCC §§ 9-309(3) or (4) as described above, Broadway's security interest in the Participation Interest was nonetheless perfected at the time that the Receiver became a lien creditor because Broadway had actual and/or constructive possession of the Boardwalk Note.

UCC § 9-313(a) allows perfection of an instrument by possession, and promissory notes constitute "instruments". See UCC §§ 9-102(47).

When Broadway originally acquired its Participation Interest in May 2007, the HPC Fund acknowledged in writing (in paragraph 4 of the Participation Agreement) that it was holding the Boardwalk Note and Boardwalk Mortgage for the benefit of the holder of the Participation Interest, to the extent of such Participation Interest. The HPC Fund was therefore acting as the agent of the holder of the Participation Interest (i.e., Broadway), and possession by a secured party's agent constitutes actual possession by the secured party. See UCC § 9-313, Comment 3. Even if the HPC Fund was not acting as Broadway's agent, however, as the holder of the Participation Interest Broadway had constructive possession of Boardwalk note under UCC § 9-313(c) due to the HPC Fund's acknowledgement in writing that it held the original Boardwalk note for the benefit of the holder of the Participation Interest. Either way, Broadway's security interest in the Boardwalk Note was perfected by actual or constructive possession.

As referenced above, Broadway's security interests in the Boardwalk Mortgage and the Participation Agreement were also perfected automatically, because the perfection of a security interest in a promissory note is also automatic perfection of a security interest in a mortgage

Mohsin N. Khambati, Esq.  
Dewey & LeBoeuf, LLP  
September 10, 2009  
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securing such promissory note, see UCC §§9-308(e), and the perfection of a security interest in collateral is also automatic perfection of a security interest in a supporting obligation for such collateral. See UCC §§9-308(d).

Broadway continued to have actual or constructive possession of the Boardwalk Note after it sold its Participation Interest to High Yield. The Sale Agreement provided for Broadway to retain a collateral assignment of the Boardwalk Note, Boardwalk Mortgage and the Participation Agreement pursuant to the Collateral Assignment. The HPC Fund was a party to the Sale Agreement, and expressly approved the sale of the Participation Interest and the Collateral Assignment. Accordingly, Broadway continued to be the holder of the Participation Interest, and therefore continued to enjoy the rights of the holder of the Participation Interest under the Participation Agreement. These rights included the HPC Fund's acting as the Participation Interest holder's agent and the benefit of the acknowledgement in writing that the HPC Fund holds the original Boardwalk note for the benefit of the Participation Interest holder.

Moreover, a secured party having possession of collateral does not relinquish possession by delivering the collateral to a person if, before or contemporaneously with the delivery, such person was instructed (i) to hold possession of the collateral for the secured party's benefit or (ii) to redeliver the collateral to the secured party. UCC § 9-313(h). The Sale Agreement expressly provided for High Yield's simultaneous collateral assignment of the Participation Interest to Broadway, which constitutes an instruction satisfying the criteria in both clauses (i) and (ii) above. Therefore, Broadway's original possession (actual or constructive) of the Participation Interest, including the Boardwalk Note, was never relinquished by the sale to High Yield.

**III. Even if Broadway's Security interest is Unperfected, under Principles of Equitable Subrogation the Receiver's Interests as a Lien Creditor are Subordinate to Broadway's Interests.**

Even if Broadway's security interest in the Participation Interest is not perfected, under principles of equitable subrogation the Receiver's interests as a lien creditor will be subordinate to Broadway's interests in the Participation Interest.

Under principles of equitable subrogation, courts will apply an equitable remedy even where the UCC would seem to dictate a different result. See, e.g., In re: United Auto Mart, Inc., No. 08-17916 (NLW), 2009 WL 1749061, at \*6 (Bkrtcy.D.N.J. June 19, 2009)(citing Kaplan v. Walker, 395 A.2d 897, 900-901 (App.Div. 1978)). Thus, even where a security interest in unperfected, courts will apply the principles of equitable subrogation to subordinate a receiver's status as a lien creditor under the UCC. Id. The Receiver and this Court should apply this same analysis.

Here, Broadway contributed \$5,125,000.00 to the \$7,750,000.00 loan to Boardwalk, and never received any payment from Boardwalk. Broadway sold its Participation Interest to High Yield, extended a loan to High Yield for the agreed-upon purchase price of \$5,125,000.00 plus interest, and never received a payment from High Yield. Subsequently, the HPC Fund acquired

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the Property through a credit bid of the Boardwalk Note in a sale authorized by the New Jersey Bankruptcy Court pursuant to Section 363 of the Bankruptcy Code. Additionally, the Participation Agreement anticipates such an acquisition by the HPC Fund, and expressly provides that the HPC Fund now holds the Property for the joint benefit of the HPC Fund and the Participation Interest holder (i.e., Broadway), and gives the Participation Interest holder the right to repayment in full of the Bank Portion of the Boardwalk Note and loan before any repayment can be made in respect of the portion of the Boardwalk Note and loan contributed by the HPC Fund.

Moreover, equitable subrogation is appropriate here given the policies behind perfection requirements. The rationale for the UCC requiring a financing statement filing, or possession or control of collateral, to perfect a security interest in collateral is to provide notice to the world that the secured party may have a security interest in the collateral. If an instrument indicates that it has been assigned to an identified secured party, a purchaser of the instrument has knowledge that the purchase violates the rights of the secured party. See UCC §9-317(f). Here, no party could acquire the Participation Interest from High Yield without knowledge that the purchase violates the rights of Broadway as the secured party. Broadway and HPC Fund are the co-lenders/co-mortgagors listed on the face of the documents constituting the Participation Interest, and High Yield's only evidence to a third party that it subsequently acquired any interest in the Participation Interest is the Sale Agreement, which clearly indicates on its face that the Participation Interest and all rights and benefits therefrom was assigned back to Broadway as security for the repayment and performance of the High Yield Note. Thus, there is clear notice to the world of Broadway's security interest in the Participation Interest.

The considerations set forth in Parts IV and V below of this letter provide further support for equitable subrogation to apply to Broadway's security interest.

Also, if the Receiver and this Court were to deprive Broadway of its right and interest in and to the Participation Interest, it would be tantamount to blessing the fraud committed by High Yield upon Broadway (as described in Part IV below). And the fraud committed by High Yield upon Broadway is of very different nature than the Ponzi scheme fraud committed by the Wextrust entities. Broadway was providing purchase money financing, and bargained for a secured creditor position with respect to specifically identifiable property (i.e., the Participation Interest) and the proceeds thereof, which in this case are also specifically identifiable (i.e., the Property).

Based on these facts, even if Broadway's security interest is not perfected, the Receiver and this Court should apply the principles of equitable subrogation to subordinate a receiver's status as a lien creditor under the UCC.

**IV. The Sale of Broadway's Interest to High Yield is Voidable**

Even if Broadway's security interest in the Participation Interest is not perfected, Broadway entered into the Sale Agreement with High Yield based upon a material

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misrepresentation amounting to actual legal fraud. Accordingly, the Sale Agreement is voidable and Broadway is entitled to the equitable remedy of rescission.

Rescission is an equitable remedy which can be afforded to one party under a contract because of the other party's fraud. Douglas v. Wones, 120 Ill.App.3d 36, 47-48, 76 Ill.Dec. 114, 123, 458 N.E.2d 514, 523 (1983). A party seeking rescission must restore the other party to the status quo existing at the time the contract was made. Puskar v. Hughes, 179 Ill.App.3d 522, 528, 127 Ill.Dec. 880, 884, 533 N.E.2d 962, 966 (1989).

In the present case, High Yield was formed as part of an elaborate Ponzi scheme in which a massive web of interrelated entities was created to defraud investors of millions of dollars. When High Yield entered into the Sale Agreement with Broadway, it did so with the covert intent to use stolen monies to repay the promissory note issued by High Yield to Broadway as payment of the purchase price. Of course, funds stolen from investors could never be used to satisfy High Yield's obligation to repay Broadway. Thus, Broadway entered into the transaction with High Yield based upon a material misrepresentation amounting to actual legal fraud.

Accordingly, the Sale Agreement is voidable and Broadway is entitled to the equitable remedy of rescission. Rescission would restore each party to its original position – i.e., Broadway would own all right, title and interest in and to the Participation Interest and High Yield would own no interest whatsoever in the Participation Interest.

**V. The Receiver Does not Have Authority to Void Broadway's Security Interest, which is Superior to the Receiver's Interest, if Any.**

Even if Broadway's security interest in the Participation Interest is not perfected, the Receiver does not have authority to void Broadway's security interest in the Participation Interest.

It is a fundamental rule in receivership cases, whether Federal or State, that when the Receiver is appointed he takes all property that is subject to existing liens, and equities and the establishment of the receivership does not divest a secured creditor of his right to enforce liens and charges against property of the estate. A receiver takes its property and assets subject to all existing legal and equitable liens or claims arising by contract or by operation of law, because the receiver merely stands in the place of the company over whose property he or she has been appointed receiver. 16 Fletcher Cyc. Corp. § 7785 (2009).

It is a very different situation with respect to a trustee's powers in a federal bankruptcy proceeding. The Bankruptcy Code establishes priorities of claims and procedures to deal with claims and interests that are being altered by the bankruptcy. Whereas a receiver marshals assets for the benefit of defrauded investors subject to creditor rights that exist in state law, a trustee acts for the benefit of creditors subject to an established federal law in the Bankruptcy Code setting up priorities and procedures. For a receiver to act as if it were empowered like a trustee in bankruptcy would fly in the face of due process of law. There is no law in place to authorize a

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receiver to “take” any rights a creditor has. Accordingly, the Receiver does not have authority to void Broadway’s security interest in the Participation Interest.

That is why Judge Chin’s July 23, 2009 Opinion of the Court properly provided that collateral be turned over to secured creditors and this is why, in Broadway’s view, the Receiver has failed to abide by Judge Chin’s July 23, 2009 opinion of the Court by not acknowledging Broadway’s rights to the Participation Interest.

Sincerely,



James B. Daniels

cc: The Broadway Bank  
Nesenoff & Miltenberg, LLP