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RECEIVER

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CLERK, U.S. DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA
BY DEPUTY

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA, Plaintiff, v. L. DONALD GUESS; LESLIE S. BUCK; DAVID JACQUOT; MONTE T. MELLON; G. THOMAS ROBERTS; CHRIS G. EVANS; NIGEL BAILEY; DOCTORS BENEFIT INSURANCE COMPANY, LTD.; DOCTORS BENEFIT HOLDING COMPANY; DOCTORS INSURANCE SERVICES, INC.; XELAN INVESTMENT SERVICES, INC.; XELAN ANNUITY CO., LTD.; XELAN ADMINISTRATIVE SERVICES, INC.; XELAN FOUNDATION, INC.; XELAN OF TEXAS, INC.; XELAN, INC.; XELAN; THE ECONOMIC ASSOCIATION OF HEALTH PROFESSIONALS, INC.; PYRAMIDAL FUNDING SYSTEMS, INC., dba XELAN INSURANCE SERVICES; XELAN PENSION SERVICES, INC.; XELAN FINANCIAL PLANNING, INC.; EURO-AMERICAN TRUST COMPANY; AMS TRUST COMPANY; and JOHN DOES, UNKNOWN PERSONS WHO ARE RECEIVERS OF XELAN LONG TERM CARE TRUST, XELAN DISABILITY EQUITY TRUST, XELAN MALPRACTICE EQUITY TRUST, and XELAN MEDICAL SAVINGS EQUITY TRUST, Defendants.	Case No. 04-CV-2184 LAB (AJB) RECEIVER'S INITIAL PRELIMINARY REPORT Date: December 3, 2004 Time: 1:30 p.m. Judge: Honorable Larry Alan Burns

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TO ALL PARTIES AND THEIR ATTORNEYS OF RECORD:

Please take notice that William E. Leonard as Receiver for the various xélan-related entities hereby files this Initial Preliminary Report of the Receiver.

Dated: November 24, 2004

WILLIAM A. LEONARD, JR.
Receiver

Dated: November 24, 2004

SULLIVAN, HILL, LEWIN, REZ & ENGEL
A Professional Law Corporation

By:

James P. Hill, Esq.
Donald G. Rez, Esq.
Attorneys for William A. Leonard, Jr., Receiver

INITIAL PRELIMINARY REPORT OF RECEIVER

The Temporary Receiver respectfully submits this initial report to advise the Court of his preliminary observations and findings. Given the limited time the Receiver has had to assess the situation and issues it is important to note the preliminary nature hereof.

1. On November 3, 2004, the Honorable Thomas J. Whelan signed an order entering a Temporary Restraining Order and appointing William A. Leonard as Temporary Receiver over several xèlan related entities. On information and belief the order was served on all U.S. parties and has been served on numerous financial institutions wherein estate funds may be located. The Temporary Receiver was to take possession of the assets identified in Exhibit A to the Temporary Restraining Order (Exhibit 1 to this report) and to secure the premises where the defendants maintained records that were the subject of the Order. The assets identified in Exhibit 1 included, "all property" held by the defendants and listed 47 known accounts at several financial institutions.

2. Upon commencement of the Temporary Receivership, William A. Leonard entered the San Diego offices of the defendants and systematically inventoried the fixed assets on the premises. That inventory is attached as Exhibit 2 to this report. The Receiver then personally contacted the financial institutions to verify that funds on deposit were frozen and to value those assets. A list of identified accounts is attached as Exhibit 3 hereto. Efforts to identify property are ongoing and are detailed in the remainder of this initial report. In conjunction with the commencement of the TRO the United States Government served a search warrant on the xèlan premises at 401 West A Street, Suite 2210. The Receiver has procured a detailed inventory of the seized items and fully cooperated with the agents while they were on site and thereafter.

BACKGROUND

3. The civil action was brought by the United States against the above named defendants for fraud and for the enjoinment of schemes designed to evade tax liabilities.

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4. xélan, Inc.,[1] is a California corporation that was established to provide financial counseling services to doctors. The xélan companies began with the formation of The Economic Association of Health Professionals ("EAHP" or "Association") circa mid-1970. EAHP was established as an association for member doctors to which xélan, Inc. marketed its financial planning services (and later the financial products of other xélan companies). The Association and the company sponsored financial education seminars for doctors and researched and developed planning structures to help the members prevent losses of pre-retirement income to disability, death and income taxes.

During 1975, xélan, Inc. began to recruit and train financial counselors to implement the financial plans prepared for the member doctors. In 1999 xélan's Founder and Chairman, L. Donald Guess, DMD, described the program as follows: "These xélan Tax Reduction Plans created individualized financial structures that limited doctors' income tax losses to lifestyle cost needs and allocated remaining pre-tax surplus earnings to deductible savings plans." 1999 xélan Annual Review p. 1, Exhibit 4 hereto. More recently it has been said that these xélan "Capital Accumulation and Capital Distribution Plans" were designed to create individual financial structures that prevented losses of earnings due to pre-retirement death or disability and to "unnecessary" income taxes and investment risk, and allocated pre-tax surplus earnings to deductible retirement plans. When doctors joined the Association, they would pay a membership fee and certain annual dues. Payment of these fees would entitle the member to xélan, Inc.'s financial planning services as set forth above. xélan, Inc. would design a written financial plan for the specific member, recommending certain financial strategies tailored to that member. These included recommendations for income protection, insurance, investments and qualified retirement planning and charitable giving. This plan was provided to the financial counselor for explanation to the doctor. The doctor could then retain the financial counselor to implement the plan. Those financial counselors worked under contract with xélan, Inc. (and later the other xélan companies described below).

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[1] Judge Dalzell in his opinion concerning certain xélan tax issues noted that "xélan, … like 'e.e. cummings' eschews capitalization …" *Cohen* v. *United States* 306 F. Supp. 2d 495, 497 fn 1 (E.D. Pa 2004). According to xélan promotional material: "In 1974 the name xélan was adopted for the Economic Association of Health Professionals membership program, combining 'x', the individual's savings required to finance lifestyle costs through life expectancy with 'élan', the French word meaning a lifestyle of personal freedom." 1999 Annual Review p. 1 (Exhibit 4 attached).

Over time, purportedly at the request of Association members, xélan, Inc's management expanded the services available, specifically in the area of life, health and disability insurance, pension services, investment services, and charitable giving services. During 1999, the Securities Exchange Commission (SEC) audited xélan's operations, and objected to the variety of functions being performed by a single entity. For example, xélan, Inc. was preparing financial plans; xélan Insurance Services was selling the insurance called for in the plans, and xélan Investment Services was selling the investments called for in the plans. These entities were not all separately incorporated at the time. The SEC informed xélan that it needed to comply with certain additional regulations regarding the custody of investment funds (such as obtaining monthly audited financial statements, etc), or restructure in a way that would avoid the perceived conflicts.

The business was therefore restructured by creating separate entities for the planning and investment management functions that were subject to particular licensing or regulatory requirements.

5. The Complaint of the United States, filed under seal on October 4, 2004, alleges that the defendants have been operating a number of schemes to defraud members of the public - medical doctors, in particular - by soliciting their participation in a number of purported insurance, retirement, investment, and charitable giving arrangements. The Complaint alleges that these arrangements are not what they purport to be, but have been established and used for purposes other than as presented to the doctors. The Complaint further alleges that the defendants have also established and used these schemes to defraud the Unites States of taxes, by establishing, selling and maintaining non-tax-deductible retirement savings plans in the guise of tax-deductible insurance and charity programs.

The Complaint alleges that the defendants had been aggressively soliciting medical doctors around the country to participate in schemes that the defendants represented to prospective participants to be legal methods to amass savings for retirement, with pre-tax dollars. These programs involved alleged supplemental insurance arrangements, that purported to provide supplemental insurance to corporations that doctors set up under xélan's guidance. In these programs, each of the corporations were to annually pay for so-called supplemental insurance (for disability, long-term care, medical savings, and/or malpractice insurance) through xélan from a "captive" (or "exclusive") offshore insurance company, originally xèlan Insurance Co. but now Doctors Benefit Insurance Co ("DBIC"), which purports to be an "independent" Barbados-licensed insurance company, which would then issue "certificates of insurance" purporting to evidence insurance.

The Complaint further alleges that the defendants fraudulently advised doctors that their subchapter S corporations could deduct 100% of the payments as "ordinary and necessary" business expenses under the Internal Revenue Code (26 U.S.C. §162), though the "premiums" apparently bear no relation to the cost of any insurance, but merely reflect what the doctor believed he could afford to save towards retirement in any given year. The defendants fraudulently failed to disclose that another section of the Internal Revenue Code (26 U.S.C. §419(a)) places strict limits on the deductibility of insurance premiums, and that the payments that xélan doctors made for the xélan supplemental insurance programs were not fully deductible because of that section. The Complaint further alleges that the defendants fraudulently failed to disclose that xélan doctors may not be able to exclude from their gross income all of the money that their corporations paid to xélan for this "supplemental insurance." In furtherance of this scheme, one of the named defendants prepared "tax opinion letters" that fraudulently omitted the correct tax advice and fraudulently failed to disclose his relationship with xélan, and his role as a Director of DBIC. The Complaint (and moving papers) raises concerns that approximately $22,000,000 was recently moved from the various DBIC investment accounts to an off-shore account in Bermuda (Bank of Butterfield) and raises concerns about other DBIC related accounts such as the David Jacquot, Esq., client trust account in San Diego that was apparently used as an operating account for DBIC.

The Complaint (and moving papers) also raises concerns about the activities of the xèlan Foundation, a "donor directed" charitable foundation. Specifically allegations are made concerning improper payments made to Foundation members by the Foundation - for example, the program by which Foundation doctors could make a charitable contribution in one year, and in later years, perform "pro bono" work, request that they be compensated by the Foundation for that work from assets they had previously contributed, and then have the option of being paid then or having the payment "deferred" for many years (until retirement). Allegations are also made that Foundation members were directing the Foundation to pay the college tuition of their children and other relatives with the pre-tax dollars they had contributed to the Foundation. There was also serious concern that commencing in May of 2004 xėlan had levied a 10% assessment on all the assets controlled by the Foundation raising approximately $3.2 million and segregating it into a separate account. It was not clear where those funds were being expended, but there was concern that it was not for legitimate charitable purposes.

BANKRUPTCY FILING BY CERTAIN ENTITIES

6. Four of the xélan entities, more particularly described below, filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of California on June 30, 2004. The main purpose of this emergency filing was to facilitate the sale of the pension services group to a newly created entity, Greenbook, Inc. for $800,000.

a. **xélan, Inc., Bk Case No.: 04-05832** xélan, Inc. focused primarily on financial planning and analysis for Association members, marketing and business development for the other entities, organizing and presenting seminars for new members, and training the financial counselors to market xélan's services and concept.

i. Revenues were derived from membership fees and consulting fees, each reduced by 20% to fund the Viatical Liquidity LLC settlement.

ii. The 9/30/04 Monthly Operating Report indicated net sales of $124,434, which included a reimbursement from Greenbook of $90,111.

iii. Assets include cash ($27,021), receivables ($37,771), FF&E ($122,672) and deposits ($222,528) for a total of $409,992.

b. **Pyramidal Funding Systems, Inc. dba xélan Insurance Services, Inc., Bk Case No.: 04-05833**

Pyramidal Funding Systems, Inc., dba xélan Insurance Services, Inc. is a licensed insurance agency, but is not an insurance company. As such, it did not underwrite or issue insurance policies or annuity contracts. The company executed agency contracts to sell individually owned life insurance, disability income insurance, long term care insurance policies, and annuity contracts to the members through the xélan financial counselors, who are licensed insurance agents. The policies were issued and underwritten by separate insurance companies.

i. Pyramidal derived its revenues in the form of insurance and annuity commissions, which, prior to splitting with the counselors (70/30) were reduced by 20% to fund the Viatical Liquidity LLC settlement.

ii. The 9/30/04 Monthly Operating Report indicated net sales of $784,499 and transfers to Greenbook of $1,785,935.

iii. Assets include cash ($1,000,264), receivables ($124,808), and FF&E ($1,567) for a total of $1,126,639.

c. **xélan Financial Planning, Inc., Bk Case No.: 04-05834** xélan Financial Planning was never operational, it was in its formative state only. Its purpose was to prepare the xélan "Capital Accumulation and Capital Distribution Plans" and "Annual Update Plans" for members.

i. The 9/30/04 Monthly Operating Report lists no assets and no revenue or expenses.

d. **xélan Pension Services, Inc., Bk Case No.: 04-05835** xélan Pension Services is a wholly owned subsidiary of xélan, Inc. and was the first separate service entity developed by xélan. The function of the company was to provide member doctors with individual pension plan design and annual administration. Separate accounts are created for each pension plan. Funds with the account are managed according to applicable state and federal law. This company does not hold the individual doctor's investment property.

i. Revenues are derived from setup and administration fees paid by member doctors.

ii. The 9/30/04 Monthly Operating Report indicated net sales of $2,107.

iii. Assets include cash ($23,776), receivables ($144,106), FF&E ($30,078) and deposits ($548) for a total of $198,508.

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AFFILIATED COMPANIES

7. xélan established a number of affiliated companies, each sharing the asset management fees of the funds under management. The financial statements indicate a significant number of intercompany receivables.

a. **Doctors Benefit Insurance Co, LTD** Doctor's Benefit Insurance Company, Ltd ("DBIC") is an insurance company licensed under the Exempt Insurance Act CAP 308A of Barbados. It underwrites certain Association group policies that are exclusive to the xélan family of companies, supplemental disability, medical malpractice, long-term care and medical savings plans. That entity is under independent management.

i. Revenues are generated from group insurance premiums paid by doctor members through trusts established for that purpose. All premiums paid by the members are recorded as revenue and invested primarily in Vanguard funds in defined trusts.

ii. Assets as of 9/30/04 were $532,885,103 including $1,542,464 in promissory notes and receivables. Liabilities were future policy benefits and claims by members. Total liabilities as of 9/30/04 were $530,792,215. As of the last available information the liquid assets[2] appear to be:

- **xélan Long Term Care Trust** Funds held in Vanguard as account #66-9968001029, totaling $37,661,954 have been frozen.
- **xélan Disability Equity Trust** Funds held in Vanguard as account #66-9968000758, totaling $421,955,150 have been frozen.
- **xélan Malpractice Equity Trust** Funds held in Vanguard as account #66-9968000897, totaling $27,113,902 have been frozen.
- **xélan Medical Savings Equity Trust** Funds held in Vanguard as account #66-9968000664, totaling $20,736,673 have been frozen.
- **Royal Bank of Canada** (Barbados) – A/C #800-321-2: $136,081
  - main operational account of DBIC;
  - used to pay accounts payable (by wire to U.S. payees);

[2] Counsel for DBIC has stated that no assets of DBIC are being expended during the Temporary Receivership.

- **Wachovia Bank, N.A.** (London) – A/C # 04978026 $678,249
  - clearing account for funds transferred out of Vanguard (mostly claims related);
  - if claim is to be paid by wire, it is wired directly from this account;
  - if claim is to be paid by check (most), the funds are transferred to the Harrisburg claim account;
- **Wachovia Bank, N.A.** (Harrisburg) – A/C # 2000011699822 $479
  - claims account (used to pay most claims, experience adjusted refunds, etc.);
  - this account is necessary so insureds can be paid with U.S. domestic checks that clear on a timely basis (vs. international checks that take up to 6 weeks to clear);
- **Wachovia Bank, N.A.** (Harrisburg) - A/C # 2000013029584 $127,260
  - Money Market account;
  - Used to keep a limited balance on hand to pay other obligations from time to time (excise taxes, etc).
- **Bank of Butterfield** (Barbados) – A/C # 33548 $18,834,931
  - Money Market account;
  - Original deposit was $22 million;
  - Reserves to pay legal fees and bond obligations.
- **Citizens Bank** (Tom Roberts Trust Account used) $131,680
  - Account used for the Bond Settlement Liquidating Trust;
  - Used to pay bond obligations;
  - Used to pay premiums on viatical life insurance policies owned by DBIC.

b. **xélan Investment Services, Inc.** xélan Investment Service, Inc. ("Investment") is a separate California corporation, which is licensed as a registered investment advisor (RIA). Investment does not hold investor assets. Investment derives its revenues from three separate sources:

i. Setup and Administration fees. Revenue from set up and administration fees are paid in various amounts by doctor members and xélan Foundation.

ii. Fund Raising Fees. Fees are generated from the pre-agreed upon commissions from charitable donations from xélan Foundation (usually 6% of the contribution). Investment has an agreement with the counselors that the counselors receive 70% of these fees. Investment then splits this fund raising fee 70% going to financial counselors. Both Investment Services and the counselors reduce the amount received by 20% to fund the Viatical Settlement.

iii. Investment Advisory Fees are paid from the following sources and Investment then splits this fund raising fee 70% going to financial counselors. Both Investment Services and the counselors now reduce the amount received by 20% to fund the Viatical Settlement.

(1) Association members pay Investment asset management fees consisting of 1% per annum of assets under management paid on a quarterly basis. (These funds are e.g., independent IRA's managed by xélan, which are owned by members and only managed by xélan, are not frozen.)

(2) DBIC pays Investment asset management fees consisting of 1.2% per annum of assets under management paid on a quarterly basis (with the .2% being rebated to DBIC).

(3) Foundation pays Investment asset management fees consisting of 1% per annum of assets under management paid on a quarterly basis.

c. **xélan Administrative Services, Inc.**

[Information being gathered.]

d. **xélan Foundation, Inc.** xélan Foundation is a non-profit charitable organization under §501(c)(3) of the Internal Revenue Code. The deductibility of contributions under this foundation is discussed below and challenged by the Internal Revenue Service. The Foundation generates it revenues from charitable donations paid directly by doctor members. Of this amount, a pre-determined commission, (generally 6%), is paid as a fund raising fee to xélan

Investment Services, Inc. Investment then splits this fund-raising fee 70% going to financial counselors. Both Investment and the counselors reduce the amount received by 20% to fund the Viatical Settlement.

e. **xélan of Texas, Inc.** xélan of Texas is a Texas corporation formed under the laws of Texas and is separately owned. It was originally created to comply with Texas insurance laws that required that insurance commissions paid in the State of Texas flow through a Texas corporation. This company has derived its revenues in the form of insurance commissions. This company, then splits these commissions 70% going to financial counselors. Both Investment and the counselors reduce the amount received by 20% to fund the Viatical Settlement. According to the Texas Comptroller of Public Accounts xélan of Texas is "not in good standing" under either taxpayer ID number identified with it. Exhibit 5.

f. **xélan, the Economic Association of Health Professionals, Inc.** The xélan companies began with the formation of The Economic Association of Health Professionals circa mid-1970. The Association was established as an association of the member doctors to which xélan, Inc. marketed its financial planning services (and later the financial products of other xélan companies). The Association sponsored financial education seminars for doctors and researched and developed planning structures to help the members with their financial planning needs. The Association itself has existed as an unincorporated membership organized since 1974, but was incorporated in 1996. The Association generates its revenues from membership fees paid directly by its members. DBIC makes its supplemental programs available exclusively to members of the Association.

XÉLAN FOUNDATION

8. With the exception of bank statements and bank balances that were obtained by the Receiver, all exhibits referenced below were obtained with the assistance of S. Wakefield, the Foundation's administrator, from computerized records of the Foundation. Although the Receiver has reviewed these reports for reasonableness, they have not been verified through review of third party documentation.

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a. **Overview**

The xélan Foundation ("Foundation") is a non-profit charitable organization under §501(c)(3) of the Internal Revenue Code, which was incorporated in 1997, but first began accepting donations in 1996. xélan receives revenues from the Foundation by charging a $1,500 set-up fee for each new account ($800 of which goes to xélan), a 6% commission charge on most contributions made to the Foundation, an annual administration fee of $550, and an annual investment management fee of 1% of assets. Approximately 400 doctor members availed themselves of this xélan program. The members were advised by xélan counselors that they could receive a tax deduction for charitable giving ("contributions") and then direct the charitable giving ("donations"). Funds were mainly invested with SEI and to a lesser extent in annuities and viaticals. At the doctor's direction, funds in the doctor's charitable trust would be directed into the following as "charitable giving": (i) Pro Bono Projects; (ii) Student Loans; and, (iii) Donations to Charitable Organizations.

b. **Foundation Contributions and Disbursements**

Since its inception, the Foundation has received aggregate contributions of $64,268,131 and has earned $3,496,101. Attached hereto as Exhibit 6 is the Foundation's unaudited summary income statement as of November 12, 2004.

i. **Contributions.** Of the $64,268,131 in contributions discussed above, approximately $40,259,413 was received in cash. The remaining contributions were received in real estate, stock, gift annuities, and other miscellaneous assets. Attached hereto as Exhibit 7 is a detailed listing of the cash contributions to the Foundation. The Receiver has reviewed a transaction-by-transaction report, which lists the activity of the Foundation's main cash operating account at First National Bank ("FNB"). This report shows that approximately $81,844,333 of cash was deposited into the operating account between January 1, 1996 and November 5, 2004. Although the Receiver intends to research this issue further, it appears that the discrepancy between the $64,268,131 of total contributions to the Foundation discussed above and the deposits per the FNB report are due to the redepositing of certain cash items and account transfers. The FNB account was used as a clearing account whereby contributions were temporarily deposited until they could be transferred to an investment bank (SEI was the most commonly used bank). Later when the Foundation was directed by a contributor to use the funds to make a donation to a charitable organization or to otherwise transfer funds; the funds were redeposited into the FNB account temporarily until the funds were donated or transferred.

ii. **Disbursements**. The Receiver is continuing to collect information on all disbursements from the Foundation. However, the Receiver can report that with the exception of fee payments, the Foundation primarily distributed funds for the following charitable purposes:

- **Pro Bono Projects**. Foundation contributors submit descriptions of their charitable projects to the Foundation for approval. Attached hereto as Exhibit 8 is a pro bono project listing. Once a project receives approval, the contributor submits receipts to the Foundation for reimbursement from the contributor's Foundation account. Donated services were originally paid at 100% of the contributor's customary rate but were recently reduced to 80% of the customary rate. Attached hereto as Exhibit 9 is a detailed listing that shows $939,834 in compensation being paid to pro bono project contributors to date. Payments to donors for their services could apparently be deferred until a later date chosen by the contributors. The Foundation's balance sheet shows deferred compensation payable to pro bono project donors of $4,069,080. [See Exhibit 10].
- **Student Loans**. The Foundation made student tuition payments from contributor accounts to universities and other educational institutions for children designated by the contributor, including the contributor's children and relatives, to attend school. The contributors were told that the loan recipients would have to repay or "work off" the loan through charitable work within 5 years from graduation. However, the records for the student loans were poorly maintained and

as a result, the Foundation does not know when each student graduates or if they have graduated. To date, one student loan has been repaid, by the son of a contributor (without interest and only after an IRS investigation of that doctor had commenced). Attached hereto as Exhibit 11 is a copy of the student loan detail report that shows $3,132,871 has been disbursed for student loans to date.

- **Donations to Charitable Organizations.** Donations to verified tax-exempt charities are disbursements made from a contributor's account when they request that a donation be made to a particular charity. Attached hereto as Exhibit 12 is a report that shows total donations of $11,227,092 to charitable organizations made by the Foundation.

c. **Foundation Assets** The Foundation's unaudited balance sheet as of November 12, 2004 (attached hereto as Exhibit 10) lists $47,545,363 of gross assets consisting of the following:

Asset	Book Balance	Bank Balance as of 9/30/04
SEI Funds	$23,418,105	$25,002,115
Schwab Funds	$1,023,334	$930,084
Misc. Brokerage Funds	$779,245	(1)
Life Insurance/Viaticals	$1,778,563	N/A
Annuities	$10,331,379	N/A
Student Loans	$3,159,458	N/A
Real Estate	$6,698,812	N/A
Notes Receivable	$356,467	N/A
Schwab Legal Defense	$0	$2,528,773 (2)
Total	$47,545,363	

(1) The Receiver is still investigating the bank balances of these accounts but he believes that approximately $620,000 of this balance are investments in Doctor's Bancorp, parent of Beach Business Bank.
(2) See discussion at ix infra.

i. **SEI Funds.** The Receiver has obtained a balance report from SEI as of September 30, 2004 that shows the Foundation's accounts total $25,002,115. The Receiver believes that the difference between the amount reported per SEI and the Foundation's balance sheet is due to quarterly earnings that have not yet been posted to the Foundation's accounting system. Attached hereto as Exhibit 13 is the SEI balance report referenced above.

ii. **Schwab Funds**. The Receiver has obtained bank statements for the Foundation's Schwab accounts, which show an aggregate balance as of September 30, 2004 of $930,084. The discrepancy between the book and bank balance may have to do with losses that have not been allocated to the donor accounts. The Receiver intends to research this issue further. Attached hereto as Exhibit 14 is a summary of the Schwab accounts and their respective balances

iii. **Brokerage Funds**. The Receiver is in the process of researching these accounts to determine their bank balance. The Receiver has frozen all accounts of which he is aware. The Receiver currently believes that approximately $620,000 of this balance are investments (stocks and warrants) in Doctors' Bancorp, the parent company of Beach Business Bank.

iv. **Life Insurance and Viaticals**. Attached hereto as Exhibit 15 are copies of the life insurance and viaticals detail reports. The Receiver is investigating further to determine whether the value of the viaticals listed on the balance sheet is accurate, but this seems doubtful given the purpose and history of Viatical Liquidty, LLC.

v. **Annuities**. Attached hereto as Exhibit 16 is a copy of the annuity detail report. The Receiver is investigating further to determine whether the value of the annuities listed on the balance sheet is accurate.

vi. **Student Loans**. Attached hereto as Exhibit 11 is a copy of the student loan detail report. The loan balance per the detail report is $3,132,871, which does not materially vary from the balance reported on the Foundation's balance sheet.

vii. **Real Estate**. Attached hereto as Exhibit 17 is a copy of the real estate sales log and listing of real estate for sale. The Receiver's review of the real estate for sale log and discussions with xélan employees indicates that the $6,698,812 balance per the balance sheet may not be accurate because some of the real estate and other assets listed are not supported by appraisals. The Receiver is further investigating the true value of these assets. Some of these "contributions" have been held for many years with the doctors "instructing" the Foundation not to market or sell these properties. The Receiver is currently unaware of how such properties are being used.

viii. **Notes Receivable**. Based on discussions with S. Wakefield and a review of the note receivable files, approximately $1,100 of the outstanding notes receivable balance is for notes taken on the sale of real estate. The remaining balance of notes receivable appear to be for investments in viaticals that were transferred to notes receivable due to viatical settlements.

ix. **Schwab Legal Defense**. On May 28, 2004, the Foundation sent a letter to all Foundation contributors notifying them that due to examinations initiated by the IRS, 10% of each contributor's account balance would be surcharged to create a legal defense fund. SEI declined to allow an across-the-board withdrawal so the money was withdrawn in increments from the individual accounts. Once received, the 10% fees were deposited into a new account at Charles Schwab. Checks were then written from this account for legal defense and other operating expenses.

Attached hereto as Exhibit 18 is a detailed report that shows $3,213,694 for the 10% legal fee was withdrawn from contributors' accounts. The Receiver has reviewed the bank account activity for this account and verified that the 10% fees were deposited into this account. The disbursements from this bank account total $664,327 and were primarily legal fees paid presumably to defend certain contributors under IRS audit. Approximately $115,577 of this amount was disbursed from this account to pay administrative fees to xélan, post bankruptcy filing, and $133,091 was returned to contributors' accounts or donated because the Board of Directors acceded to the demand not to make the assessment on two individual contributors. The resulting bank balance of this account is $2,528,773, which is currently frozen. Attached hereto as Exhibit 19 is a copy of the transaction history report for this bank account, and as Exhibit 20 is the list of disbursements from the fund. The minutes of the Special Meeting of the Board of Directors of xélan Foundation approving the assessment but exempting the "accounts" of Drs. Ravindra and Udita Jahagirdar are attached as Exhibit 21 hereto; and the letter from Dr. Guess advising of the assessment is Exhibit 22.

IDENTIFIED FINANCIAL DEPOSITS

9. The Receiver has identified a number of financial institutions that are holding funds for the benefit of defendants. A complete listing of these funds can be found on attached Exhibit 3 and totals $561,207,906.

On the commencement of the Receivership, six cashiers checks were outstanding. Of those six checks, four checks, totaling $997,764.91, have been recovered and are being held by the Receiver. The other two were deposited into accounts of the Debtor in Possession at Torrey Pines Bank. The held checks are listed below:

(1)	xélan Welfare Benefit Trust	$222,036.20
(2)	xélan Annuity Co. LTD	$ 1,882.09
(3)	David Jacquot JD	$663,701.51
(4)	Bond Settlement liquidating Tr	$110,111.02

See Exhibit 23 for a copy of these cashier's checks.

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DEPOSITS

10. xélan and its affiliated companies may have paid retainers and deposits to various entitles for services to be rendered. All of the identified entities have been noticed of the Receivership and the funds on account, if any, have been requested to be frozen. Included are:

a. Roberts & Paton

b. Johnson Lambert & Company

c. Law offices of Michael C. Durney, Esq.

d. Friday, Eldredge & Clark

e. Sadden Arps Slate Meagher & Flom, LLP

f. Hogan & Hartson, LLP

g. Hanson, Bjork & Russell, LLP

h. Law offices of Michael R. Suverkrubbe, Esq.

i. Blank Rome, LLP

j. Hochman, Salkin, Rettig, Toscher & Perez, PC

k. Latham & Watkins, LLP

l. Chicoine & Hallett, P.S.

m. Michael L. Lipman (Coughlan, Semmer & Lipman)

n. John L. Morrell, Esq. (Higgs Fletcher & Mack)

ONGOING BUSINESS

11. There are several interrelated businesses with on-going business activities.

a. **Greenbook**. Greenbook Financial Services, Inc. was incorporated on May 28, 2004. Robert Holcomb, Greenbook's sole shareholder, was formerly the CTO (Chief Technology Officer) for some of the xélan entities before he left in April 2004. Greenbook was incorporated for the purpose of purchasing the assets of the four xélan entities placed into bankruptcy (xélan, Inc., Pyramidal Funding Systems, Inc. dba xélan Insurance Services, Inc., xélan Financial Planning, Inc., and xélan Pension Services, Inc.) pursuant to a Notice of Motion to sell substantially all assets of the debtors free and clear of liens and encumbrances not in the ordinary course of business. On August 4, 2004, Judge Louise DeCarl Adler, United States Bankruptcy

Judge, signed an order approving the Amended and Restated Business Asset Preservation Agreement ("BAPA") among Greenbook Financial Services, Inc. and xélan, Inc., xélan Financial Planning, Inc., Pyramidal Funding Systems, Inc. dba xélan Insurance Services, Inc. and xélan Pension Services, Inc. Pursuant to that Agreement, Greenbook offered at-will employment to at least 65% of the debtors' employees. It associated with the "agents/counselors" of the xélan entities and commenced to operate the day-to-day business of the debtors including, without limitation, "providing written financial plans, designing and administering pension plans, selling insurance, and producing educational services and symposiums, including the use of Owner's trade name and other Intellectual Property." It provided for Greenbook to "use the equipment of the Business" and to "pay any and all rent and other payments" for real property leases and equipment leases. At the time of the entry of the Temporary Restraining Order, Greenbook was firmly ensconced in the property of the debtors utilizing the debtors' former employees, utilizing the premises, utilizing the books and records (including all of the computer records, spreadsheets, and hardware and software) of the xélan entities. Where Greenbook began and the xélan entities ended was not readily discernable.

It may be of interest that "Greenbook" is a xélan term of art. The overall xélan program is predicated upon clients accumulating "Critical Capital Mass," which is defined as the amount of capital needed to provide for a member/doctor's "lifestyle costs." Members who have not yet accumulated "Critical Capital Mass" are provided with a personalized Capital Accumulation Plan, referred to as the "Red Book." After a member has accumulated "Critical Capital Mass," the member is provided with a personalized Capital Distribution Plan, referred to as the "Green Book." Hence the name Greenbook for those programs offered to members who have accumulated Critical Capital Mass.

b. **Viatical Settlement.** On or about June 18, 2004, Viatical Liquidity, LLC filed a voluntary petition for relief under Chapter 11 in the United States Bankruptcy Court for the Southern District of California (case No. 04-05472). According to papers filed by Viatical Liquidity in the Bankruptcy Court:

Viatical Settlement Contracts ("VSC") are a beneficial interest in a life insurance policy of the terminally ill that is transferred at a discount of its face value. When the insured under the policy (known as the "viator") dies, the insurance company pays to the then beneficiaries of the policy, the face amount of the policy. Each VSC has multiple individual beneficiaries named as its irrevocable beneficiaries of the policy. VSCs were offered, promoted and sold to the general public through, among others, two programs. The first program was known as the National Viatical Trust Program (the "NVT Program"). The second program was known as the Reliance Program (the "Reliance Program"). The programs were virtually identical. Disputes arose by the purchasers of the VSCs challenging the promotional material of the VSCs. In response thereto, the Debtor (Viatical Liability), a limited liability company established originally in Idaho and subsequently in the state of California, was formed for the purpose of accepting a beneficial assignment of all right, title and interest in the VSCs purchased by third parties through xélan, Inc. and its related companies ("xélan Purchasers"). In exchange for an agreement to directly pay the xélan Purchasers their expected benefits under the VSC purchases, Viatical Liquidity was to be substituted as the beneficiary on many of the policies underlying the VSCs purchased by the xélan Purchasers. Additionally, the xélan Purchasers assigned to Viatical Liquidity all right, title and interest in any causes of action, which they may had had relating to the sale, promotion, or administration of the NVT and/or Reliance VSCs.

Thus, Viatical Liquidity agreed to purchase the VSCs from the third party owners and xélan, Inc. would provide the funds to Viatical Liquidity necessary to (1) purchase the VSCs from the third party owners; (2) pay premiums to keep life insurance policies underlying the VSCs in force; and (3) fund administration and litigation efforts. In that regard, a Viatical Buyout Settlement and Release and related Secured Promissory Note Settlement and Release were entered into between the xélan purchasers, xélan, Inc. and Viatical Liquidity. However, xélan, by the time of the bankruptcy filing, had become unable to continue making payments to Viatical Liquidity. Based thereon, Viatical Liquidity was not able to perform its obligation to complete purchase of the VSCs because the funding from xélan was diminished. As a result, the promissory notes to the xélan purchasers are in default. According to the default remedy provision in the promissory notes, Viatical Liquidity holds the VSC interests in constructive trust for the benefit of xélan purchasers in case of a default. Viatical Liquidity apparently intends to reassign the interests in the VSCs back to the xélan purchasers. However, until that process is completed, it is necessary that the insurance premiums be paid so the policies do not lapse. Thereafter, it will still be necessary for the xélan entities to make necessary premium payments.

The Receiver is investigating the potential size of this asset for each xélan entity. The asset has been serviced, at least in part, by an assessment of 20% of the fees earned by xélan entities and xélan counselors from earnings from payments of premiums and management fees. As these fees declined, so did the ability to service Viatical Liquidity with such percentage payments. Upon information and belief, Greenbook has been negotiating to become involved. Viatical Liquidity's assets prior to the receivership were at xélan and its records were on the xélan server. Subsequently, Viatical Liquidity has moved to Greenbook's new office location.

c. **xélan held viaticals.** A viatical is "of or relating to the contractual arrangement in which a business buys life insurance policies from terminally ill patients for a percentage of the face value." *American Heritage Dictionary* (4th Ed. 2000). In March 2002, there was an assumption agreement between DBIC and xélan Insurance Co. (BVI) by which DBIC replaced xélan. xélan Insurance Co. had a viatical program, which had evolved as follows: An independent company "Robin Hood" had purchased viatical contracts from terminally ill patients. Those terminally ill patients had procured life insurance policies at some earlier time from a third party insurance carrier. Premiums continued to be due under those policies. For a percentage of the death benefit face value (perhaps $200,000 on a $500,000 policy) Robin Hood became both the owner and the beneficiary of the policies. Robin Hood, however, was not in the business of holding these investments and sought investors to buy the right to be beneficiaries. xélan helped market these viaticals to its stable of doctors. Doctors purchased the viatical contracts (perhaps the hypothetical $500,000 policy would be purchased by doctors (or a consortium thereof) for $350,000 from Robin Hood. As part of the arrangement, the doctors were guaranteed a return of the face value of the insurance policy within 3 or 4 years. Robin Hood remained the owner and paid the premiums, the doctors were named as the beneficiaries. Robin Hood then purchased bonds to insure the policies, and after United Fidelity (the initial bond company) collapsed, all such bonds for xélan doctors were provided by xélan Insurance/DBIC. Premiums in excess of $1.7 million (upon

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information and belief) have been received by DBIC for assuming this bond obligation. Thus, if the viator has not passed at the end of the three or four year period when the bond comes due, Robin Hood is contractually obligated to pay the doctors holding the viaticals the face value of the policy, and DBIC is obligated to pay Robin Hood the face value of the policy. In return, DBIC after paying Robin Hood the face amount of the policy is assigned ownership of the policy and becomes the named beneficiary of the policy. It is then obligated to pay premiums to maintain the life insurance policies in effect until the viator dies, at which time DBIC receives the full face value of the policy. Currently, DBIC has 53 premium obligations and owns life insurance policies in the amount of $21,744,690. There are seven bond obligations remaining due which total $4,927,306.91 including one that became due on November 15 in the amount of $499,997. (On November 27, 2004 a $1,747.98 premium to keep that policy in effect will also come due - that payment will not be made by Robin Hood but will be the responsibility of DBIC.) See, 3 page Exhibit 24 Doctors Benefit Insurance Company Ltd. Other Investments Lead Schedule As Of September 30, 2004 (Investment In Viaticals); Bond Supplement Liquidating Trust; and Bond Settlement Liquidating Trust Premium Cash Flow, Fiscal Year 2005. The "Bond Liquidating Trust" has been set up to facilitate this arrangement. It is an entity with its own tax I.D. number but it is wholly owned by DBIC. David Jacquot was the trustee until May 3 of 2004 when he abruptly resigned. Tom Roberts has been appointed to take his place. Steve Farrington provides the accounting services. Because the viaticals will pay-off at an unknowable time and because premiums on the investment will continue to become due (at the rate of $770,932.96 per year) until the viators pass away, the value of the viaticals is not known and DBIC has fully reserved for this "asset." DBIC has actively marketed its book of viaticals and has not been able to sell them.

xélan Foundation also owns viaticals. However, upon information and belief, it has no premium obligation and it simply receives checks from the Viatical Liquidating Trust, LLC which is in bankruptcy. However, unless funds are released to Viatical Liquidity to makes its premium payments, etc., the Foundation's investment in viaticals is at risk.

d. **xélan Investment Services**. Continues to manage assets as described above.

e. **Monthly expenditures.** There are numerous variables which may effect expenditures. On-going expenditures will be predicated upon whether the BAPA (with Greenbook) continues or is modified and whether the Receivership is continued with the authority to make expenditures and whether these expenditures are for liquidation or current operations.

DOCTORS' BENEFIT INSURANCE COMPANY (DBIC)

12. **Doctors Benefit Insurance Company, Ltd** ("DBIC") was incorporated in Barbados under the Companies Act of Barbados on December 18, 2001 and is a wholly-owned subsidiary of xélan Insurance Holding, Ltd, a company incorporated in Barbados. It is licensed under the Exempt Insurance Act CAP 308A of Barbados to engage in long term insurance business and its principal activity is to provide supplemental disability, long term care, medical malpractice and medical savings programs exclusively to members of xélan, the Economic Association of Health Professionals, Inc. On March 22, 2002, DBIC entered into an assumption agreement to assume all of the insurance liabilities and related assets of xélan Insurance Company Limited of the British Virgin Islands in respect of certain group policies and viatical contracts issued by the company. According to its audited financial statement DBIC's Directors are Dr. Monte T. Mellon (a medical doctor residing in San Diego, California), Mr. G. Thomas Roberts (a graduate of the University of Pittsburgh School of Law, listed as an INACTIVE attorney by the website of the Disciplinary Board of the Supreme Court of Pennsylvania) and Christopher G. Evans (a resident of Barbados). The Officers are Mr. Nigel Bailey (of the British Virgin Islands), Christopher G. Evans, and Ms. Ella Hoyos. The Investment Manager is The Vanguard Group in Malvern, Pennsylvania and the Consulting Actuary is Tim K. Robinson a consulting actuary with Niis/APEX of Princeton, New Jersey. The Outside Auditors for the company are Ayub Kola & Co., Chartered Accountants of Barbados.

The DBIC system now works as follows: payments made by doctors into any one of the four DBIC programs are collected by the third party administrator (now Patton and Roberts). On a weekly basis these payments are collected and packaged in two separate Federal Express shipments to either the Nerine Trust Company (for the long term care, medical savings, or supplemental malpractice program) or the Euroamerican Trust Company (for the supplemental disability program), both in the British Virgin Islands. Attached as Exhibit 25 is a schematic showing the money flow of trust contributions and premium payments. The trustee receives the checks and deposits them into the appropriate trust account; this deposit is designed to be a contribution to a trust. Once the checks clear, usually within eight days, the trustee wires the money to Vanguard. Thus there are four Vanguard accounts, one for each of the programs; this money is not segregated by individual participant. The cash balances in each of the Vanguard accounts is set forth in the following chart:

As of Date: November 11, 2004

Plan Number	Plan Name	Plan Market Value
10152	DBIC Medical Savings	$20,736,672.95
10301	DBIC Disability	$421,955,150.06
10303	DBIC Malpractice	$27,113,901.78
10310	DBIC Long Term Care	$37,661,953.62
	Total:	$507,467,678.41

Johnson Lambert & Co. was retained to do "premium accounting" and statement preparation services relating to the Vanguard investment; the third party administrator (Patton and Roberts) maintains the "Smart" database reconciling and keeping track of the amount each doctor has "invested" and the amount that the investment has grown. Patton and Roberts also has the responsibility of interfacing with the members and the salesmen (called "counselors") for both payment and claims purposes. Tom Roberts (of Patton & Roberts) is one of the defendants herein, is a director of DBIC, is the trustee of the Bond Liquidating Trust (relating to viatical contracts) and provided tax opinions in conjunction with the original and subsequent iterations of xélan supplemental "Insurance" programs but is currently listed as "inactive" by the Pennsylvania Supreme Court. (Exhibit 26.)

Claims are processed as follows: an insured files a claim form and submits the claim to the administrative office in the British Virgin Islands. The British Virgin Islands administrative office logs the claim and forwards it to their U.S. attorney. The U.S. attorney then performs a claims analysis and prepares a recommendation to the claims committee. The claims committee (consisting of Nigel Bailey, Tom Roberts, and Chris Evans) meets monthly to discuss open claims and approve or deny them. Approved claims are then processed and paid monthly and tracked through Patton and Roberts. Funds are disbursed to Wachovia Bank in London from Vanguard and then either wired directly to claimants' accounts or to Wachovia in Harrisburg for payment to claimants or rebate recipients.

In late 2003-early 2004 consideration was given to filing Chapter 7 Bankruptcy Petitions for numerous (all) xélan entities. This included the Economic Association of Health Professionals, Inc., for which DBIC is licensed to provide supplemental disability, long term care, medical malpractice and medical savings programs exclusively. This meant that consideration was given to the liquidation of DBIC. Purportedly in conjunction with the contemplated liquidation, funds at Vanguard were transferred to The Bank of Butterfield in Bermuda in the amount of approximately $22,000,000. As of September 30, 2004, $18,834,931.20 remained there. Instead of being used to liquidate DBIC these funds were transmuted into an operating account, for payments relating to viaticals, and a legal defense fund, payments from which have been largely to outside services including law firms. A summary of general and administrative expenses of DBIC for the twelve months ending September 30, 2004 is attached hereto as Exhibit 27. Attached as Exhibit 28 is the 2003 audited financial statement and as Exhibit 29 are the unaudited balance sheet and income statement as of September 30, 2004.

DBIC had a second "operating" account held at the First National Bank in San Diego in the name of the "David Jacqout, JD, LLM Tax State Bar of California Legal Services Trust Fund Program". $35,468,146 from various DBIC sources were deposited into the account and $34,804,445 was withdrawn. Much of those funds went to the payment of viatical obligations (upon information and belief at least $20,000,000). See summary of bank activity for account number 90116005 attached hereto and summary of account activity 90117185 showing the deposit from the David Jacquot Trust Account and payments to viatical bond obligations and premiums thereon. Exhibits 30 and 31 hereto. The Receiver has possession of cashier's checks closing out those accounts in the amounts of $663,701 and $110,111 respectively. (See discussion at 13a. below.)

Currently the bulk of the DBIC assets are held in money market accounts at Vanguard in the amount of $507,467,678.41. $18,834,931.20 (as of September 30, 2004) is held at The Bank of Butterfield (in Bermuda). There is an investment in viaticals in the amount of $21,744,690 which has been fully reserved for (see viatical discussion, infra). As of September 30, 2004 total assets were estimated to be $532,885,103 and total liabilities $530,792,215. However included in the liability for "future policy benefits and claims" is a $42,000,000 surplus which has been allocated to the insureds - according to the audited financial statements dated September 30, 2003 (Exhibit 28, page 14, fn. 11). According to an analysis prepared by Steve Farrington, DBIC's outside CPA, DBIC shows a $775,480 solvency surplus as of September 30, 2004 (with the $42,000,000 surplus built into liabilities as additional reserves). DBIC has a loan receivable from David Jacquot, with principal and accrued interest totaling $843,700 as of September 30, 2004.

The DBIC program currently operates by having pre-tax dollars paid in for one or more of the supplemental benefits programs offered by DBIC (disability, long term care, medical, or (in the past) malpractice). The payments are claimed as an "ordinary and necessary" business expense by the corporation and the program is offered solely to the member doctor (and not to other employees of the corporation). Currently, because DBIC cannot give a clean tax opinion it is not writing any new business; however it continues to collect substantial payments from existing members of the programs.

DBIC pays xélan Investment Services a 1% net asset management fee for the funds held at Vanguard (a 1.2% fee with the .2% being rebated to DBIC). A member is required to contribute a minimum of $4,000 per annum or previous years' contributions are subject to forfeiture. A vesting occurs at 7 years entitling a member to the return of the funds paid (as an "Experience Adjusted Refund" not to exceed 94% of the premiums paid in). Death divests the members of entitlement to payments. A member apparently has flexibility in determining the amount to pay each year, between the minimum (of $4,000) and a maximum predicated on total investment as a percentage of income. Fees have included an annual administrative fee of $650 and an initial set-up fee of $1,950. Historically, 94% of the members' payment went to the investment manager (now Vanguard) with xélan entities receiving the remainder.

ADDITIONAL ISSUES DEALT WITH

13. Numerous additional issues have been dealt with including:

a. **Missing Cashier's Checks (First National Bank)**

One of the initial issues addressed by the Receiver was an effort to gain understanding and control of assets at the First National Bank ("FNB") accounts which had been listed on Exhibit A, items 1 through 39. (Exhibit 1 hereto.) Late on the evening of November 4 (after 7:00 p.m.) the Receiver received a report which showed that on October 18, 2004, six of those accounts had been closed with the purchase of cashier's checks (numbered 150540 through 150545) which at that time were still outstanding. The Receiver immediately commenced efforts to recover those outstanding cashier's checks which totaled $1,049,577.50. Initially neither FNB nor any of the employees that had been associated with xélan reported that these accounts had been forcibly closed at the insistence of FNB and the cashier's checks delivered to xélan's offices. Instead, given the exigencies of the allegations, the Receiver expended substantial efforts to track down the missing checks.,

On Friday November 5 at 7:00 p.m. it was learned from FNB that two of the smaller cashier's checks had been negotiated. On Monday (November 8) it was learned that those checks had been deposited into secured accounts of the debtor-in-possession of xélan at Torrey Pines Bank. Thereafter former xélan employees (working with Greenbook) disclosed that FNB had closed out the accounts and delivered the cashier's checks to the xélan offices and that the remaining cashiers checks had been in filing cabinets at the xélan premises at the time of the execution of the search warrant but were now missing. The Receiver worked closely with the federal agents who had taken possession of the contents from the premises during the search to attempt to locate the cashier's checks. On Friday, November 12 the government agents reported that a review of the files isolated by the Receiver failed to discover the missing cashier's checks. Under instructions of the Receiver, counsel for the Receiver began his own search and was able to locate the "missing" cashier's checks in a different file cabinet than that which had been identified as the cabinet in which the checks had been placed. The four cashier's checks are now securely under the control of the Receiver. (Copies of the checks are Exhibit 23.)]

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b. **In Re Viatical Liquidity, LLC (USBC (SD CAL) Case No. 04-5472-H11)**

During the initial inspection of the property on November 4 the Receiver observed that several files and a computer terminal and desk were marked with handwritten signs reading: "Do Not Disturb. Property of Viatical Liquidity, LLC." On November 8 the Receiver's counsel received a telephone call and then a follow-up letter by facsimile from Gary Rudolph, counsel for Viatical Liquidity, LLC, the Chapter 11 debtor-in-possession. He requested permission to have Viatical's employee, Merfit Mansour be given access to the secured premises to move the computer and files owned by Viatical Liquidity. Timing was critical because maintaining payments on viatical insurance policies are essential to maintaining the assets of this debtor (and it was claimed the computer maintained information necessary to make required filings with the bankruptcy court). Late on November 9 a second letter was received demanding access within 24 hours or a court's intervention would be sought. Meantime the Receiver (who had not been given any formal instructions by the Temporary Restraining Order concerning this issue), was in consultation with Stuart Gibson, Esq., the senior litigation counsel for the Tax Division of the US Department of Justice who had been instrumental in procuring the Temporary Restraining Order. Early on November 10, Mr. Gibson, on behalf of the US Department of Justice, and the Receiver, agreed to make the requested assets available to Viatical Liquidity. Thereafter Mr. Rudolph and Ms. Mansour realized their request had been inadequate in that the information they required was on a xélan server and not on the hard drive of the computer they requested. The Receiver was able to make arrangements for that portion of the server to be downloaded to a CD (while leaving the xélan server completely intact with all information that was on it). Counsel for the Receiver continued to deal with Ms. Mansour including making the offices of xélan available for the supervised removal of the Viatical LLC files on Sunday November 14, 2004. Upon information and belief these files and computers have been relocated to the new offices of Greenbook in San Diego.

c. **Missing G-Drive (xélan Foundation)**

On November 10, 2004, the Receiver became aware of the necessity of continuing the employment of xélan Foundation employee Cheryl Wakefield. On November 12, 2004, Ms. Wakefield returned to her office to assist the Receiver in running reports relating to the xélan

Foundation assets, contributions, donations, balance sheets, and to ensure security of the remaining assets. In attempting to run the requested reports (including reports relating to student loans, the real estate held by the Foundation and particularly the "pro bono" work of the doctors and payments to the doctors relating to that pro bono work) it was determined that a complete computerized file (or Drive G) was "missing." All attempts to access Drive G which contained these materials indicated that Drive G had been deleted. The Receiver made efforts to ascertain the existence of backup tapes. Backup tapes were in fact discovered and it was determined that Drive G had been backed up as of November 1, 2004. The Receiver was able to use the backup to reinstall Drive G as it existed as of November 1. Based on the efforts it would take to delete this "shared file" it is very unlikely that Drive G had been deleted by accident. The Receiver is coordinating with the governmental agencies to determine whether Drive G was imaged during the execution of the search warrant on November 4 and 5 and thereafter deleted, or whether it was deleted on November 3. Foundation employee Sheryl Wakefield has reported she was working on Drive G on November 3 and even November 4 when her work was interrupted by the service of the search warrant by federal agents. However, the Receiver was able to access the backup and no data was lost. (Some of the data was also available on Drive C and that data confirms the integrity of the information procured from the backup tapes.) The governmental agencies in charge of the search have been apprised of this situation.

d. **Inter-Relationship Between Temporary Restraining Order, xélan Debtors-In-Possession, and Greenbook**

On November 4, 2004, when the federal agents arrived at the xélan premises at 401 W. "A" Street, Suite 2210, and when the Receiver arrived shortly thereafter, it was ascertained that several former employees of the xélan bankruptcy entities who were then (and are now) employees of Greenbook, were physically possessing the xélan sites and using the xélan assets as described in the BAPA with Greenbook set forth above. Most of the xélan employees were now Greenbook employees; the xélan assets remained assets of the estate but were being operated by Greenbook. Given the Temporary Receiver's charge of securing the premises where assets were located and securing and taking possession and control of all assets of xélan (including the entities operating as debtors-in-possession under Chapter 11), there were significant issues to be resolved with the relationship with Greenbook. Discussions with in-house counsel for Greenbook (Silas Harrington) and counsel for the debtors-in-possession (John Morrell of Higgs Fletcher & Mack) commenced immediately while federal agents were still on the premises. Telephone meetings with counsel for Greenbook (Dennis Wickham of Seltzer Caplan and Mitch Dubick) continued throughout the day resulting in a face-to-face meeting at the end of the day, Thursday November 4, 2004. As the Receiver and government attorneys came to better understand the inter-relationship between Greenbook, the debtors-in-possession and the Restraining Order, it was agreed that the receptionist could sit in the xélan offices on Friday November 5 to answer phones and take messages for Greenbook (and xélan) business.

The following week, as government agents had concluded imaging computers and seizing documents, Greenbook employees (who had been allowed to continue to use an adjacent suite, suite 2250 which was not covered by the search warrant) were allowed on-site and by Thursday November 11 were operating the Greenbook business pursuant to the BAPA. This followed daily contacts and communication with counsel for Greenbook and Greenbook principal Bob Holcomb. Significant time has been expended dealing with the Greenbook situation.

The parties agreed to an interim solution where funds coming into the xélan offices were held pending the ability of all parties to the bankruptcies and the Receivership Order, including representatives of the governmental agencies, to meet on Monday November 15. At that time the parties agreed to further discussions and to await the Bankruptcy Court's determination of the motion to name a trustee for the bankrupt xélan entities. On November 22 a formal appointment was made by the U.S. Trustee and the Receiver is now the Trustee of the bankrupt entities. This allows for appropriate continued discussions.

e. **Preliminary Injunction Hearing/Scope of Receivership**

Defendants and the Government have made requests for information to assist them in preparing for the preliminary injunction hearing now scheduled for December 3, 2004 at 1:30 p.m. The Receiver has cooperated and expended time and effort in providing significant documents to both sides, especially concerning the xélan Foundation. Specifically, all documents requested by Nicole Chicoine and John Coyne were hand-delivered to John Farrington as they requested (John

Farrington is an outside accountant for the Foundation), and John Farrington was given supervised access to the Foundation's database for purposes of assisting defendants (and this Receiver). Similarly all documents that could be identified from the request of Frank Johnson were hand-delivered to him and explained to him. Moreover Nicole Chicoine was told defendants had access to Sheryl Wakefield (the sole remaining Foundation employee) when she was not otherwise engaged; an offer defendants took advantage of.

The Receiver has spent significant time dealing with issues arising from the fact this is an asset procuring receivership without operational authority. Negotiations with the Government and certain defendants have been on-going concerning operational issues, including efforts concerning a stipulation expanding the scope of the Temporary Receiver.

RECOMMENDATION RE SCOPE OF RECEIVERSHIP

14. The direction and scope of the Receivership must be changed at this point. xélan and its affiliated entities were conducting a myriad of inter-related businesses. The operating income came from two sources. The first was the asset management fees of approximately 1% of the funds invested; the second source of income was the commission on the insurance renewal premiums. The recipient of the asset management fee income was xélan Investment Services, Inc. and the recipient of the commission on insurance renewal premiums was xélan Insurance Services, Inc.. While the commissions on the insurance renewal premiums will continue for the foreseeable future, the asset management agreement with DBIC is terminable at any time by DBIC upon notice.

15. The funds received were allocated to the various entities on, primarily, a need basis, after payment of certain expenses. The major current and/or recurring expenses for DBIC include at least the following:

a. CGE International Insurance Services - $16,670 monthly payment to Nigel Bailey (Barbados agent), due for October, 2004. If not paid, Bailey could resign and cause DBIC to be placed under a Barbadian conservatorship.

b. International Captive Consultants, Inc. - $15,484 monthly payment to Christopher Evans, balance due through September, 2004. If not paid, Evans could resign, threatening DBIC to be placed under a Barbadian conservatorship.

c. Niis/APEX - $9,935 for actuarial consulting and year end calculations, due October, 2004. Without this payment, acturarial services necessary for the year end (9/04) audited financials will not be completed. Again, if the audited financials are not prepared in a timely manner, DBIC may be placed under a Barbadian conservatorship.

d. Roberts & Patton - $71,200 ($18,540 current invoice and $52,660 for November services). As third party administrator, if payments are not made, claims may not be adjudicated in a timely manner.

e. Johnson & Lambert - $26,636. Premium accounting for July – October 2004.

f. MMAS, Inc. – Fees due Dr. Monte Mellon as director of DBIC. No immediate negative impact for non-payment.

g. Estate attorneys - $163,620. Combined total of six firms representing xélan and its entities in various litigation. No immediate negative impact for non-payment.

h. Viatical Bond (2106) obligation - $499,996 due 11/15/04. Without this payment, the estate will suffer a significant potential loss and, more than likely, will have liability for this loss.

i. Viatical bond (2106) obligation monthly premium - $1,748 due 11/27/04. Without this payment, the estate will suffer a significant potential loss and, more than likely, will have liability for this loss.

j. Viatical investment premiums - $54,272 due December, 2004.

16. The Receiver understands there is an agreement between Investment and the counselors that provides that 70% of the asset management fee must be paid to the counselors (less the 20% that is paid to Viatical Liquidity). Upon receipt of fees xélan has a corresponding obligation to pay counselors their pro rata share of asset management fees collected; furthermore the Receiver must allocate 20% of these fees to fund the Viatical Liquidity settlement. Demand has been made by Viatical Liquidity, LLC for immediate payment of a quarterly fee in the amount of $251,000 which was due on October 1, 2004. Failure of this payment jeopardizes the ability of Viatical Liquidity to pay premiums necessary to maintain policies in effect. Failure to pay counselors jeopardizes continued asset management fee income to xélan entities.

17. Under the Business Asset Preservation Agreement ("BAPA"), xélan Insurance Services, Inc. (Pyramidal Funding Systems, Inc.) was to turn over to Greenbook all commissions on insurance premiums and Greenbook, in turn, was responsible for all operating expenses, including without limitation, rent, utilities, employee salaries, and commissions paid to agent/counselors who produced such fees and revenues. The original BAPA was to be a short-term arrangement. It must be reviewed and renegotiated based on current conditions.

18. The remaining obligations of the non-debtor companies consists of office and furniture/equipment leases, utilities, and two employee salaries.

CONCLUSION

19. The current scope of the Receivership was to immediately identify and marshall assets of the companies and its principals. Much has been accomplished swiftly. The company *offices were secured and hard and computer based assets were inventoried.*

Meantime, the government is investigating whether any of the entities were engaged in criminal activity. The Receiver will make every effort to identify and preserve any evidence relevant to a criminal investigation, and will be able to identify and present relevant evidence to the United States Attorney's Office in a way that will be helpful to the prosecutor's evaluation of the activity.

20. To the extent this Receivership continues the scope of this Receivership needs to be expanded from the current status of an "asset" receivership. Funds need to be paid from the four entities in bankruptcy to continue the BAPA agreement. Funds need to be paid for the other entities from those held in the Receivership for ongoing and necessary expenses.

21. Most importantly, the Receiver needs the authority to make business decisions regarding the continuation, termination, modification or sale of business activities. Mechanisms need to be put in place for the Receiver to procure instructions on an ongoing basis and/or to be given sufficient authority to make the necessary business decisions.

Dated: November 24, 2004

WILLIAM A. LEONARD, JR.
Receiver

Dated: November 24, 2004

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