UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,	)	
Plaintiff,	)	Case No. 06 C 4859
v.	)	Hon. Robert W. Gettleman
AA CAPITAL PARTNERS, INC. and JOHN ORECCHIO,	)	Hearing Date and Time: February 21, 2007 1:30 p.m.
Defendants.	)	

MEMORANDUM OF RECEIVER IN SUPPORT OF MOTION FOR AUTHORITY TO CONSENT TO BRUSH MONROE PARTNERS, LP'S SALE OF INTEREST IN XYIENCE

W. Scott Porterfield, Receiver for AA Capital Partners, Inc. ("AA Capital"), submits this memorandum in support of his motion for authority to consent to the sale by Brush Monroe Partners, LP ("Brush Monroe") of a portion of its interest in Xyience Incorporated ("Xyience").

A. Brush Monroe's sale of its Xyience stock is a prudent investment decision and not prohibited by the Stockholders Agreement.

1. AA Capital manages three investment funds. Each fund is a limited partnership with investors holding limited partner interests. The present matter concerns the Brush Monroe fund.

2. Brush Monroe was created in the spring of 2006. Brush Monroe's investment activity is limited to an equity and debt investment in Xyience. Xyience is a Las Vegas-based company that markets sport drinks, energy bars and food supplements. Brush Monroe has a

$21 million equity investment in Xyience and a $10 million secured debt investment in Xyience.

3. Upon his appointment, the Receiver commenced an investigation into the Xyience investment. In that investigation, the Receiver found:

(a) The Xyience equity investment of $21 million was not subject to the due diligence process AA Capital normally used when considering an investment. In fact, it appears that AA Capital's former president, John Orecchio, personally handled the investment without the input of AA Capital's senior investment specialists;

(b) At the time Brush Monroe made the $21 million equity investment, Xyience did not have by-laws and, consequently, the rights of Brush Monroe as a stockholder were not defined;

(c) The $10 million debt investment did not have senior secured priority over all other debts, as had been intended. It appears that Mr. Orecchio waived that requirement at or near the closing of the loan and consequently the debt is now junior to the rights of other creditors;

(d) Prior to making the $21 million equity investment, Brush Monroe either conducted no due diligence of Xyience's principal owner and chief executive, Russell Pike, or the results of any due diligence were disregarded. Subsequent background checks by other investment professionals at AA Capital revealed that:

(i) Mr. Pike has been convicted of the financial crime of money laundering (See Exhibit A) and charged with multiple counts of passing bad checks (Exhibit B), and

(ii) Mr. Pike was a debtor in a bankruptcy proceeding (Bankr. D. Nev. Case no. 96-02199) in which a number of creditors, principally Las Vegas casinos and other gaming interests, sought on the basis of fraud to have him denied a discharge of all or some of his debts (See Exhibit C);

(e) Brush Monroe's $10 million note from Xyience was due and payable on September 30, 2006. Xyience did not have the money to repay the note and has not made any interest payments due under the note. Although the note permits Xyience to issue shares of Xyience stock to Brush Monroe in lieu of paying interest in cash, no shares have been issued despite repeated requests by Brush Monroe; and

(f) Xyience's monthly expenses greatly exceed its monthly income. Xyience requires large (multi-million) and continuous infusions of new capital in order

to survive long enough for its brand to take hold and generate the sales needed for profitability.

4. The Receiver submits that no prudent investment fund would make a $21 million equity investment into a company that lacked by-laws. The Receiver submits that any prudent investment fund would have conducted due diligence on the principals of a company being considered for a $21 million equity investment. The Receiver further contends that no prudent investment fund would place client dollars into a company headed by a convicted felon, particularly when the crime was financial in nature.

5. Based on the foregoing and other information available to the Receiver, the Receiver determined that Xyience is not just a distressed investment from a credit and valuation standpoint, but that the investment is part of a larger pattern of fraud, misappropriation of investor funds, fiduciary duty breaches, and other misconduct committed by John Orecchio.

6. The Receiver's objective has been to maximize the realization on Brush Monroe's investment in Xyience. Realization is complicated by the fact that the equity and debt have little inherent value in light of Xyience's present financial condition. For the year ended December 31, 2006, Xyience lost nearly $56 million on sales of about $20 million and had approximately $19 million in accounts payable and $18 million in other debts (excluding amounts owed to Brush Monroe) (See Exhibit D). Rather, the value of Brush Monroe's investment in Xyience lies primarily in the fact that Brush Monroe's debt can be converted into shares equal to 20% of the outstanding shares of Xyience and that such shares, if combined with other shares, would potentially allow a new investor to control Xyience. A new investor

could then use that control to recapitalize Xyience with substantial new money and provide it with the management needed to realize on the value of the company's brand.

7. The Receiver had communications with Xyience management in October and November 2006 regarding whether management could find a party to purchase Brush Monroe's interest in Xyience. Management identified one credible investor, but that party backed away from Xyience when it discovered Mr. Pike's criminal past. Management also repeatedly failed to respond to the Receiver's request for certain documents, including stock certificates evidencing the shares to which Brush Monroe is entitled under its loan agreement with Xyience.

8. Brush Monroe has reached an agreement with Key Management SA ("Key") under which Key will purchase, for $9,000,000 cash, the debt that Brush Monroe holds in Xyience and all but 2,500,000 of the shares of Xyience stock held by Brush Monroe. Brush Monroe has requested that Key agree to pay $9,000,000 for immediate delivery of the debt and delivery of the stock as soon as all legal obstacles have been removed. If Key will accept this modification of the agreement, the Receiver may orally modify his pending motion at the February 21 hearing. In either case, Key is ready, willing, and able to close the transaction.

9. At the Court hearing on February 13, 2007, an attorney claiming to be counsel for Xyience[1] made reference to a Stockholders Agreement that, according to Xyience, may restrict the sale by Brush Monroe of shares it holds in Xyience. A copy of the Stockholders Agreement is attached hereto as Exhibit E. Article 3 of the Stockholders Agreement contains certain restrictions on the transfer of shares. Section 3.1 permits those transfers that are

[1] Under the Stockholders Agreement, the written consent of Brush Monroe is required before Xyience may retain any lawyer. (Ex. E, Article 5.1(w)). Brush Monroe has not consented to Xyience retaining any attorney to appear in this case.

"Exempt Transfers." Section 3.2 allows transfers by a stockholder holding in excess of 10 percent if it offers "tag along" rights to the other stockholders that are party to the Stockholders Agreement.

10. Xyience appears to argue that the proposed sale of shares should not be approved because such a sale is not an "Exempt Transfer" under Section 3.1 and is thus not permitted. This argument appears to be based on the inartful drafting of the definition of "Exempt Transfer" found in Article 9.1 of the Stockholders Agreement. That definition includes in clause (a) a transfer "pursuant to an exercise of tag-along rights as an Other Holder under Section 3.2 …" but does not include a transfer that triggers the tag-along rights of the Other Holders under Section 3.2. Because the definition of Exempt Transfer does not explicitly include the initial transfer of securities subject to Section 3.2, but does include transfers resulting from the exercise of tag-along rights under Section 3.2, Xyience apparently argues that the initial proposed transfer that gives rise to tag-along rights is itself not an Exempt Transfer and, therefore, is not permitted.

11. Xyience's argument reads Section 3.2 out of the Stockholders Agreement, which clearly permits transfers by stockholders with large holdings so long as the tag-along provisions are enforced. It makes no sense to find that the Stockholders Agreement permits transfers occasioned by an exercise of rights under Section 3.2 while not permitting the transfers that triggered such rights in the first place. Section 9.7 of the Stockholders Agreement addresses how to resolve such an ambiguity: "Whenever possible, each provision of this Agreement shall be interpreted in such a manner as to be effective and valid under applicable law." This provision adopts the maxim of contractual interpretation that contracts

are to be read in a manner that gives meaning to each provision. This provision adopts the maxim of contractual interpretation that contracts are to be read in a manner that gives meaning to each provision. *Eversole v. Sunrise Villas VIII Homeowners Association*, 112 Nev. 1255, 1260, 925 P.2d 505, 509 (Nev. 1996) ("Contractual provisions should be harmonized whenever possible, and construed to reach a reasonable solution.") (internal citations omitted); *Quirrion v. Sherman*, 109 Nev. 62, 65, 846 P.2d 1051, 1053 (Nev. 1993) ("It is a well established principle of contract law, however, that where two interpretations of a contract provision are possible, a court will prefer the interpretation which gives meaning to both provisions rather than an interpretation which renders one of the provisions meaningless.") citing *Royal Indemnity Co. v. Special Service Supply Co.*, 413 P.2d 500 (1966). *Phillips v. Mercer,* 94 Nev. 279, 282, 579 P.2d 174, 176 (1978) ("A court should not interpret a contract so as to make meaningless its provisions.").[2] Applying this canon of construction to the definition of Exempt Transfer in the Stockholders Agreement leads to the conclusion that any transaction that triggers Section 3.2's tag-along rights is an "Exempt Transfer."

12. It also cannot be argued that Section 3.2 is not an independent basis under which securities may be sold, but rather relates only to transfers that occur under clauses (b) through (f) of the Exempt Transfer definition. For instance, clause (d) covers distributions of Xyience shares by a corporate stockholder to its own equity holders, a transaction that obviously would not implicate tag-along rights for Xyience stockholders.

[2] The Stockholders Agreement contains a provision requiring that it be interpreted and enforced in accordance with Nevada law. (Ex. E, Article 9.13).

13. Moreover, Section 3.2 contains over two pages of detailed provisions which, if the Stockholders Agreement is interpreted as Xyience proposes, would provide tag-along rights in extraordinarily limited, and even inapplicable, circumstances. Therefore, Section 3.2 cannot be disregarded or rendered void by a misreading of the inartful words of clause (a) of the Exempt Transfer definition. Section 3.2 clearly creates a mechanism for Brush Monroe to sell the shares it presently wishes to sell.

14. In his motion, the Receiver requests that he be granted authority to consent to Brush Monroe's agreement to sell its note and Xyience stock to Key. As demonstrated by the distressed financial condition of Xyience and the troubled history of Xyience's current management, Brush Monroe's decision to sell its note and Xyience stock is a prudent investment decision. Moreover, no investor of AA Capital has objected to the motion. The Receiver respectfully submits that prompt Court approval of the Receiver's motion is in the best interest of the receivership.

15. The Receiver further submits that the issues raised by Xyience under the Stockholders Agreement, if they need to be resolved at all at this juncture, are legal issues that can be decided by the Court without additional proceedings.

16. Finally, if the Court is troubled by Xyience's objections, the Receiver reserves his right to discuss an alternative transaction with Key whereby Brush Monroe would only sell the promissory note to Key, not any Xyience stock, thus not implicating any rights Xyience may have under the Shareholders Agreement.

B. Xyience should be required to post a bond or letter of credit to protect the investors from loss in the event that any further delay results in a loss of the proposed sale.

17. The Receiver is informed that Key is ready, willing, and able to close its purchase of the interests of Brush Monroe in Xyience and to pay Brush Monroe $9,000,000 cash for those interests. Xyience's day-to-day survival, however, depends on a steady flow of new working capital which, since early December, has been provided by Darlis Invest & Trade Corp. ("Darlis"), a company that the Receiver understands is related to Key. Darlis has told the Receiver that Darlis will cease providing such financing if the Receiver's consent to Brush Monroe's sale of Xyience stock and debt to Key remains unresolved for any further period of time. Without such financing, Xyience is flat broke, and will not be able to meet the marketing and advertising payments that it must make to preserve the value of its brand. If Xyience fails, it is unlikely that anyone will pay anything close to $9,000,000 for the Xyience interests held by Brush Monroe. Based on a liquidation analysis performed by Huron Consulting, Brush Monroe would recover only a fraction of its $10 million note and nothing on its Xyience stock if Xyience were to be liquidated.

18. At the hearing on February 21, 2007, the Receiver will have a witness in Court who can testify as to the current financial condition of Xyience and the impact to Xyience if it does not receive ongoing working capital financing. The Receiver asks that he be permitted to offer such evidence to support his request that Xyience be required to post a $9,000,000 cash bond or letter of credit should there be any further delay to Brush Monroe's ability to close its transaction with Key.

19. The Court, when acting in an equitable proceeding, has the inherent power to require security to protect a party against harm that may result from delay. *See Hecht Co. v. Bowles*, 64 S.Ct. 587, 591-92 (1944) ("We are dealing here with the requirements of equity practice with a background of several hundred years of history. The essence of equity jurisdiction has been the power of the Chancellor to do equity and to mould each decree to the necessities of the particular case. Flexibility rather than rigidity have distinguished it."). The effect of Xyience's opposition to the Receiver's motion is to enjoin the proposed transaction without invoking Rule 65 of the Federal Rules of Civil Procedure. If Xyience sought an injunction to prevent Brush Monroe from selling its interests in Xyience, it would be required under Rule 65(c) to post security for damages that Brush Monroe and its investors might suffer should they lose the opportunity to convert a distressed investment into $9 million cash. The amount of any bond to be posted is a discretionary matter, but should "ensure that the plaintiff will be able to pay all or at least some of the damages that the defendant incurs from the preliminary injunction if it turns out to have been wrongfully issued." *Coyne-Delany C., Inc. v. Capital Development Board of State of Illinois*, 717 F.2d 385, 391 (7th Cir. 1983). Brush Monroe's damages will be at least $9,000,000 if this deal is not consummated.

WHEREFORE, the Receiver requests that the Court grant the Receiver's motion for authority to consent to the sale by Brush Monroe of certain interests it holds in Xyience.

Dated: February 16, 2007

Respectfully submitted,

W. Scott Porterfield
Receiver for AA Capital Partners, Inc.

By: s/ William J. Barrett
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