CAUSE NO. CC-17-06253C

UNITED DEVELOPMENT FUNDING, L.P, A DELAWARE LIMITED PARTNERSHIP; UNITED DEVELOPMENT FUNDING II, L.P, A DELAWARE LIMITED PARTNERSHIP; UNITED DEVELOPMENT FUNDING III, L.P, A DELAWARE LIMITED PARTNERSHIP; UNITED DEVELOPMENT FUNDING IV, A MARYLAND REAL ESTATE INVESTMENT TRUST; UNITED DEVELOPMENT FUNDING INCOME FUND V, A MARYLAND REAL ESTATE INVESTMENT TRUST; UNITED MORTGAGE TRUST, A MARYLAND REAL STATE INVESTMENT TRUST; UNITED DEVELOPMENT FUNDING LAND OPPORTUNITY FUND, L.P., A DELAWARE LIMITED PARTNERSHIP; UNITED DEVELOPMENT FUNDING LAND OPPORTUNITY FUND INVESTORS, L.L.C., A DELAWARE LIMITED LIABILITY COMPANY Plaintiffs, **v.** J. KYLE BASS; HAYMAN CAPITAL MANAGEMENT, L.P.; HAYMAN OFFSHORE MANAGEMENT, INC.; HAYMAN CAPITAL MASTER FUND, L.P.; HAYMAN CAPITAL PARTNERS, L.P.; HAYMAN CAPITAL OFFSHORE PARTNERS, L.P.; HAYMAN INVESTMENTS, LLC Defendants.	§ §	**IN THE COUNTY COURT OF DALLAS COUNTY, TEXAS** **COUNTY COURT OF LAW NO. 3** **<u>AFFIDAVIT OF DALE KITCHENS</u>**

virtually worthless, (2) that the loans from UDF to its largest borrower, Centurion, were part and parcel of UDF's carrying on of its fraudulent business scheme, that loan funds were likely being misappropriated, and that Centurion was in financial distress and likely insolvent and thus had reason to be complicit in a scheme with UDF, and (3) UDF and its auditor, Whitley Penn, had failed to disclose disagreements concerning UDF's financials that caused Whitley Penn's declination to stand for reappointment as UDF's auditor, and Whitley Penn was further complicit in UDF's scheme by concealing known reportable events. These statements are described in greater detail in paragraphs 17-36 below and are also described in Plaintiffs' Petition in paragraphs 73-140.

11. As described above in paragraph 10, Hayman Capital's statements, taken in their entirety, asserted that UDF's business was engaged in intentional wrongful conduct, not merely making poor business decisions or underperforming. That distinction is highly significant. As described more fully above in regard to my professional experience, I spent much of my career involved in forensic investigations and consultations related to fraudulent business activities, including service as the national leader of Ernst & Young's practice dedicated to fraud investigations. From these experiences, I learned the bright dividing line between assertions that a business is merely underperforming versus assertions that a business is engaged in intentional wrongful conduct. Intentional wrongful conduct in the operation of the business, or even the specter of it, negatively affects the business's relationships with its lenders, customers, vendors, shareholders, etc. For example, UDF must borrow money from banks to maintain the liquidity of its operations, and banks are highly regulated entities. Banks seek to avoid risk, and banks will avoid lending to a business where that business is allegedly engaging in intentional wrongful conduct (such as, here, operating as an alleged Ponzi or Ponzi-like scheme).

12. As described above in paragraph 10, Hayman Capital's statements were false. At the time of Hayman Capital's first anonymous post made on December 10, 2015 and at all times thereafter at which Hayman Capital made additional statements to the same effect, the following was true: 1) UDF's business was <u>not</u> operating as a Ponzi or Ponzi-like scheme and was a legitimate, reasonably stable business, not a billion dollar house of cards on the verge of collapse that would send it into bankruptcy and render its shares virtually worthless, (2) the loans from UDF to its largest borrower, Centurion, were <u>not</u> part and parcel of UDF's carrying on of a fraudulent business scheme, loan funds were <u>not</u> likely being misappropriated, and Centurion was <u>not</u> in financial distress and was <u>not</u> likely insolvent and thus had no reason to be complicit in a scheme with UDF, and (3) Whitley Penn's declination to stand for reappointment does <u>not</u> mean that UDF and Whitley Penn had failed to disclose a disagreement concerning UDF's financials that caused Whitley Penn's termination as UDF's auditor, nor does it mean that Whitley Penn was complicit in a UDF scheme by concealing known reportable events.

13. Taken in their entirety, Hayman Capital's statements that UDF's business was engaged in intentional wrongful conduct via a deceptive business scheme were false. In truth, UDF's business was and remains a legitimate business that may properly be

characterized as alternative lending by which borrowers may raise financing to fund their real estate development projects when bank financing is unavailable, insufficient or unattractive in its terms. UDF's business never should have been characterized as a Ponzi scheme or Ponzi-like scheme by Hayman Capital, as there was no basis for doing so.

14. Hayman Capital asserts that its statements derive from its review of UDF's SEC filings and other public records, but the material cited by Hayman Capital does not support its statements. I have reviewed UDF's SEC filings and public records disclosed by Hayman Capital as the basis for its statements, as well as the affidavits of Kyle Bass and Parker Lewis submitted in this lawsuit on or about January 26, 2018. None of that material provides a basis for making the false statements that are described above in paragraph 10.

15. Material that Hayman Capital identifies as being part of its review actually contradicts its false statements described above in paragraph 10. For example, UDF's SEC filings show that its cash receipts on development projects were steadily increasing, which is inconsistent with a Ponzi scheme. Hayman Capital disregarded this evidence that UDF's business was not a Ponzi scheme and instead made statements asserting that UDF's business was not generating cash receipts. Hayman Capital likewise disregarded evidence that UDF's loans were collateralized in an ordinary manner and that the collateral was examined by a variety of independent appraisers, which is also inconsistent with a Ponzi scheme. Hayman Capital also disregarded evidence that UDF's largest borrower, Centurion, was a seasoned and accomplished developer which would not have reason to act as a "straw borrower" or otherwise engage in irregular loans with non-market terms as stated by Hayman Capital. Hayman Capital also disregarded evidence that UDF's auditor, Whitley Penn, was required by law to disclose any Ponzi scheme and, if it had knowledge of such a scheme, did not have the option to remain silent through the expedient of ceasing to serve as UDF's auditor, as implied by Hayman Capital. An auditor's duty to disclose fraud cannot be avoided by any means. In short, the publicly-available information, as well as the generally-known practices of lenders, real estate developers and auditors, did not support, and indeed contradicted, Hayman Capital's assertions.

16. Below, I review in more detail the statements made by Hayman Capital, categorized by the three categories of false statements identified in paragraph 10, that were used to support Hayman Capital's general assertion that UDF's business was a billion dollar house of cards—a Ponzi scheme—on the verge of collapse.

<u>**Detailed Review of Statements that UDF Was Operating as a Ponzi Scheme**</u>

17. A Ponzi scheme lacks economic substance, and the returns are fictitious returns. "Fictitious returns" (also known as "purported returns") refer to profits that are not bona fide profits, but instead fictional paper profits that are invented by the perpetrator of the scheme. Because the profits are fictional, the financial statements and records must be falsified. In the context of securities, Bernie Madoff promised consistent returns with little risk, but was depositing money into a bank instead of making actual