EXPERT REPORT OF CRAIG A. WOLSON

PURSUANT TO C.R.C.P. 26(a)(2)(B)

[Date]

Colorado District Court, Twentieth Judicial District, Boulder, Colorado

BOULDER COUNTY DISTRICT COURT BOULDER, COLORADO Court Address: 1777 6th. St. Boulder, CO 80306	
Plaintiff(s): [NAME] **v.** **Defendant(s): [NAMES]**	**▲ COURT USE ONLY ▲**
	Case number: [Number] Div.:3 Ctrm:

1. INTRODUCTION AND QUALIFICATIONS

1.01 I have been retained by [Name] ("[Shortened Name]"), [Name] ("[Shortened Name]") and [Name] ("[Shortened Name"), Defendants (the "Defendants") in this case, as an expert to support Defendants' defenses that (i) there was no swap transaction entered into between the Plaintiff, [Name] ("[Shortened Name]" or the "Plaintiff"), and [Name] and, therefore, no money could be owed with respect to any such purported transaction and (ii) even had there been such an agreement, the manner in which [Name] induced [Name] into entering into such a transaction deviated significantly from industry custom and practice, as well as relevant law. In addition, I have been asked to respond to the statements in the expert witness report dated [Date] of [Name]'s purported expert [Name]. As discussed herein, I conclude that no swap transaction was entered into between [Name] and [Name] and, therefore, that no money could be owed under any such purported transaction and that the manner in which [Name] induced [Name] into entering into such a transaction deviated significantly from industry custom and practice as well as relevant law.

1.02 I am Of Counsel to the Law Offices of John F. Lang in New York City. In addition, I am on the roster of arbitrators of the American Arbitration Association; I was chosen for this role in particular because of my expertise in derivatives and structured finance.

1.03 A copy of my Curriculum Vitae is attached hereto as Appendix A. As noted in my Curriculum Vitae, I attended the University of Michigan Law School, where I was an Articles Editor of the *Michigan Law Review*. I was admitted to the Bar of the State of New York in 1975. I began my legal career with the New York law firm of Shearman & Sterling, which at the time was the largest law firm in New York. Thereafter, I was employed by Thomson McKinnon Securities Inc. as Vice President and Assistant General Counsel, by J.D.Mattus Company, Inc. as Vice President, Secretary and General Counsel and by Chemical Bank as Vice President and Assistant General Counsel.

1.04 From 1988 until the present I have worked on hundreds of derivatives transactions. From 1988-92, I served as the main derivatives lawyer for Chemical Bank (now part of JPMorgan Chase), which at the time was the leading interest-rate swaps dealer in the world. During that time, I also served as Chemical's legal representative to The International Swaps Dealers Association (now called The International Swaps and Derivatives Association, but shortened to "ISDA" in all cases), the main trade association for dealers throughout the world involved in derivatives. I was heavily involved in the promulgation of ISDA's Master Agreement forms of 1992, which are still used throughout the industry and one of which was used by Compass and Franklin in this case.

1.05 Beginning in 1995, I worked at several law firms, including Mayer Brown & Platt, Schulte Roth & Zabel, and Cadwalader Wickersham & Taft, LLP, where my practice focused on derivatives and structured finance transactions. Virtually every structured finance transaction that I worked on involved one or more swaps, including in particular interest rate swaps.

1.06 I have been a member of The New York City Bar Association's Structured Finance Committee since 2004 and served as the Chairman of the Committee from 2004-08. The Committee consists, on a revolving basis, of 35 of the leading structured finance and derivatives attorneys in the United States; one of the main subcommittees of the Committee is our Derivatives Subcommittee. Since 2008 I have also been an active member of the American Bar Association's Structured Finance and Securitization Committee and the New York State Bar Association's Derivatives and Structured Products Committee. I have co-authored and/or edited numerous articles on securitization financing, and I have spoken at or moderated several seminar panels relating to structured finance. Appendix B lists such articles and seminars. As part of my transaction practice, as a member (and, in the case of the New York City Bar, Chairman) of these Committees and as part of my continuing legal education requirements, I have attended dozens (possibly hundreds) of meetings and seminars where interest rate swaps were discussed.

1.07 I have acted as an expert witness and/or consultant in numerous cases involving interest rate swaps, credit default swaps, and other types of derivatives. Appendix C lists the cases in which I have been deposed or testified, as well as a list of representative cases with respect to which I have been hired as an expert witness and/or consultant.

1.08 In 2006 I was chosen by *Law and Politics Magazine,* based on a survey of my peers, as a New York Super Lawyer. I have been included in *Who's Who in the World* since 1993*, Who's Who in America* since 1992*, Who's Who in Finance and Business* since 1993 *and Who's Who in American Law* since 1986.

1.09 In preparing this Report, I have relied on my general knowledge, training, experience, and expertise. In addition, I have reviewed in whole or in part the materials listed on Appendix D hereto. Both my analysis and the factual observations I make in this Declaration are, subject to Section 1.10 below, based solely on the foregoing.

1.10 My work on this matter is ongoing. I may review additional materials or conduct further analysis. I reserve the right to update, refine, or revise my opinion as appropriate.

1.11 I am being compensated for my time in this matter at a billing rate of $400 per hour (a significant decrease from my regular rate, which I agreed to as a matter of professional courtesy), with a "cap" of $5,000 for all work other than being deposed and a "cap" of $2,500 for time preparing to be and being deposed. This compensation is not contingent upon the nature of my findings or on the outcome of this litigation.

2. INTEREST RATE SWAPS—GENERAL

2.01 An interest rate swap is a financial derivative instrument under which two parties agree to exchange interest rate cash flows, based on a specified notional amount, from a fixed rate to a floating rate (or vice versa) or from one floating rate to another. Interest rate swaps are commonly used for both hedging and speculating.

2.02 Under an interest rate swap, each counterparty agrees to pay either a fixed or a float rate denominated in a particular currency to the other counterparty. The fixed or floating rate is multiplied by a notional principal amount (e.g., $1 million). This notional amount typically is not exchanged between the counterparties and is used only for calculating the size of cash flows to be exchanged.

2.03 The most common interest rate swap is one under which one counterparty pays a fixed rate to the other counterparty while receiving from the other counterparty a floating rate indexed to a reference rate (such as LIBOR, the London Interbank Offered Rate). Why would two parties enter into this sort of arrangement? Typically, because one counterparty is currently paying or will be obligated to pay a floating rate to somebody (for example, a lender) but wants to pay a fixed rate, while the other counterparty is currently paying or will be obligated to pay a fixed rate to somebody but wants to pay a floating rate. By entering into an interest rate swap, each party can "swap" its existing obligation for such party's desired obligation.

2.04 Although this may change in the future (as the result of the Dodd-Frank Act), until now interest rate swaps have not been exchange-traded. Instead, they are customized contracts that are created in the over-the-counter ("OTC") market between private parties. Firms and financial institutions (commercial banks, investment banks, insurance companies, etc.) dominate the swaps market; very few individuals participate.

2.05 Being OTC instruments, interest rate swaps can come in a huge number of varieties and can be structured to meet the specific needs of the counterparties. However, in the interest rate swaps market, there are five basic types: (1) fixed-for-floating rate swap, same currency; (2) fixed-for-floating rate swap, different currencies; (3) floating-for-floating rate swap, same currency; (4) floating-for-floating rate swap, different currencies; and (5) fixed-for-fixed rate swap, different currencies.

2.06 Interest rate swaps are used to hedge against or speculate on changes in interest rates Interest rate swaps are also used speculatively by hedge funds or other investors that expect a change in interest rates or the relationships between them. Traditionally, a fixed-income investor who expected rates to fall would purchase cash bonds, the value of which increased as rates fell. Today, an investor with a similar view could enter a floating-for-fixed interest rate swap. As rates fall, the investor would pay a lower floating rate in exchange for the same fixed rate.

2.07 Swaps are designed to be held—i.e., payments are intended to continue—until the termination date specified in the agreement. If a swap agreement terminates early—e.g., because of default by failure to pay—one of the parties may be compelled to pay a huge sum to the other. Because these amounts are based (in the case of an interest rate swap) on changes in interest rates from the time that the agreement was entered into, it is virtually impossible to estimate at the time of contracting what the payment might be at any particular later point in time. Large institutions with complex computer models often attempt to estimate what the amount might be at any point in time starting from the date

that the agreement begins and the date that the agreement terminates early (if it does). Despite this, however, most dealers will nevertheless enter into one or more "mirror" swap transactions with other dealers so that they can hedge the risk they may face from swings in interest rates. It is unlikely that an individual—even a wealthy and/or sophisticated individual, let alone an individual who knows nothing about swaps—would be able to make these kinds of calculations or have the foresight and ability to enter into an agreement that would hedge all of his/her future risks under such an agreement.

2.08 It should be fairly obvious that even so-called "plain vanilla" interest rate swap agreements—the simplest form of derivatives and the type of agreement that I have been and will be discussing in this Report—are fairly complex and can be fairly risky. They clearly are not appropriate for individuals, such as the individual Defendants, who have no understanding about how they work, who have not been warned of the potential risks, and who have not consulted with advisors who are familiar with how swaps work and the potential risks involved.

3. DOCUMENTING AN INTEREST RATE SWAP

3.01 Since the late 1980's (shortly before I began to specialize in derivatives), virtually all parties that have entered into interest rate swap arrangement have used ISDA forms. To document an interest rate swap transaction utilizing ISDA forms, three basic forms are used:

1. The Master Agreement form. Several have been adopted and used since 1987, but the most commonly used form since 1992 is the 1992 Multicurrency and Cross Border Master Agreement (the "1992 Master Agreement Form"). This is the form that was used by Compass and Franklin in the matter under consideration and is one of the forms that I, as Chemical Bank's representatives to ISDA, was involved in negotiating and promulgating. It sets forth a basic set of principles, representations and covenants that will apply to any transaction entered into between the relevant parties under it. The Master Agreement *per se* does not get changed; if changes are to be made, they are to be made in some other document such as the Schedule or the Confirmation, as described below.

2. The Schedule. This also is an ISDA form, but it can be changed to any extent that the relevant parties desire. It is used to change, add to or delete the standard terms that are set out in the Master Agreement. This is usually a heavily negotiated document. Except as otherwise set out in the specific document for a specific transaction (such as the Confirmation described below), the terms set out in the Schedule, combined with the Master Agreement, apply to all transactions to be entered into between the relevant parties under the Master Agreement.

3. Confirmation. This is the document that sets out the specific terms--in particular, in the case of an interest rate swap, the notional amount, the interest rate that one party will pay, the interest rate that the other party will pay, the dates on which the payments will be made and the date on which payment will end. The Confirmation may also change, with respect to the relevant transaction only, any of the general terms set out in the Master Agreement and the Schedule.

All three documents are necessary in order to have a valid transaction (occasionally dealers will short-circuit the process by entering into a Confirmation that incorporates by reference the terms of one of the Master Agreement forms and indicates which terms would be in the Schedule if one were to be signed). The 1992 Master Agreement Form states at the beginning: "[Name of Party] ('Party A') and [Name of Party] ('Party B') have entered and/or anticipate entering into one or more transactions (each a 'Transaction') that are or will be governed by this Master Agreement, which includes the Schedule (the 'Schedule') and the documents and other confirming evidence (each a 'Confirmation') exchanged between the parties confirming those Transactions."

Parties often sign a Master Agreement and Schedule with the thought that they may enter into one or more transactions thereunder in the future and then never actually do so. Entering into a Master Agreement and Schedule really only sets up the general framework for one or more transactions that may or may not ever be entered into.

4. BASED ON THE FACTS OF THIS CASE, NO INTEREST RATE SWAP WAS EVER ENTERED INTO

4.01 [Name] contends that an interest rate swap was entered into between [Name] and [Name], that [Name] terminated the swap early, and, therefore, under the ISDA Master Agreement an "Early Termination Amount" ([Name]'s term) is owed. If, in fact, [Name] and [Name] had entered into an interest rate swap, this might have been the case.

4.02 However, the Defendants contend that they never agreed to the terms of any interest rate swap, either orally or in writing. They contend that the Confirmation that the Plaintiff has produced as proof of the swap is a forgery. I have no evidence to the contrary or any reason not to believe the Defendants. This means that I have no reason to think that an interest rate swap was ever entered into between [Name] and [Name] and, accordingly, no reason to think that any amount is owed by [Name] or either of the other Defendants for any breach of any interest rate swap.

5. EVEN IF AN INTEREST RATE SWAP HAD BEEN ENTERED INTO, [NAME] FAILED TO MEET RELEVANT DISCLOSURE STANDARDS

5.01 In the leading case on this subject--*Procter & Gamble Company vs. Bankers Trust Company et al*., 925 F. Supp. 1270 (S. D. Ohio 1996) ("*Procter & Gamble*")--a U. S. District Court held that an agreement between the parties (a swap agreement using the ISDA forms) contained an implied covenant of good faith and fair dealing which, in turn, imposed a duty on Bankers Trust to disclose material information. The Court (Judge Feiland), in a decision handed down on May 8, 1996, (a) stated that an implied contractual duty to disclose in business negotiation may arise when (i) a party has superior knowledge of certain information, (ii) that information is not readily available to the other party and (iii) the first party knows that the second party is acting on the basis of mistaken knowledge

and (b) found in favor of Procter & Gamble ("P&G"), which had lost a great deal of money on the interest rate swap that it had entered into with Bankers Trust ("BT"). P&G claimed that BT had the sophisticated models and systems to determine the relevant leverage involved and thus the value of the agreement. P&G alleged, among other things, that this leveraged risk should have been disclosed to P&G. Despite the fact that P&G is one of the largest companies in the world and the fact that the court specifically found that P&G was "sophisticated", the court nevertheless found the level of complexity resulted in "superior knowledge" on the part of BT and held in favor of P&G.

5.02 As a result of this case, most dealers, to my knowledge, have been extremely cautious about entering into even simple swap agreements with unsophisticated counterparties. To my knowledge, a dealer will not enter into a swap agreement with a counterparty unless the dealer is convinced that the counterparty is sophisticated and fully understands all of the possible risks that could arise from the swap agreement or has hired somebody else who understands these things and has fully explained them to the non-dealer counterparty. Again, to my knowledge, dealers try to give many warnings about the possible risks and explain them to the counterparty (or his/her/its advisor) in detail. Certainly a few years ago, when one of my banking clients decided to institute a swap program that would permit the bank's individual, retail customers to enter into swap agreements with the bank, these are the kinds of procedures I advised my client to put into place.

5.03 The facts of this case clearly show that the principles of *Procter & Gamble* should apply. In particular:

1. [Name] clearly had knowledge of swaps superior to that of the Defendants. Although the Defendants may have heard of swaps, they clearly did not know how swaps work.

2. The fact that [Name] and [Name] are attorneys is irrelevant. Swaps are a highly specialized area of business and law, and very few business people or lawyers really understand swaps. To me an argument that, because they are lawyers, they should know about swaps would be the equivalent of saying to an internist "You are a doctor, so you ought to be able to do brain surgery". In case any further proof is necessary, several years ago I was hired as an expert in a case between a hedge fund and a major bank involving, among other things, the interpretation of a key clause in a swap agreement that had been entered into between the parties. One of the major causes of the dispute was the fact that both the inside counsel for the hedge fund and the outside counsel for the hedge fund, although otherwise clearly sophisticated attorneys, did not know anything about swaps and had failed to understand a key term that the hedge fund had agreed to.

3. Even if the Defendants might have been able to learn enough about swaps before the closing to have some idea about how swaps work, to my knowledge the Plaintiff had never spoken about a swap being involved until the closing. The Defendants had not asked to enter into a swap and had no idea that one was even contemplated until closing. Clearly, it was far too late at that point for the Defendants to attempt to understand the risks involved or to hire somebody to explain these risks to them. Clearly this information was not "readily available"

(to use the phrase used in *Procter & Gamble*) at this point. There was not even anybody at the closing who could have made any attempt to explain the risks. Because the Defendants thought that they were entering into a loan agreement that they could terminate at any time without penalty, which, to my knowledge, the Plaintiff clearly knew, the Plaintiff knew that the "second party" ([Name]) was acting on the basis of mistaken knowledge.

Accordingly, all three of the main tests set out in *Procter & Gamble* for setting aside a swap are present in this case.

6. RESPONSE TO EXPERT WITNESS REPORT OF PLAINTIFF'S EXPERT WITNESS

6.01 For the most part I have no disagreement with the statements in the expert witness report dated [Date] of the Plaintiff's purported expert [Name] (the "[Name] Report"). However I do take exception to certain key statements therein. In particular:

1. In the second full paragraph on page 2 of the [Name] Report, Mr. [Name] states "It is important to note [that] the swap and the loan are two distinct, separate transactions." I certainly agree with that statement. The problem arises from the fact that the ordinary person--even lawyers if they do not deal with swaps--would not know this or understand the significance of this. In my view, [Name] did very little, if anything, to fulfill its responsibility to the Defendants to make them aware of the significance of this fact.

2. In the first full paragraph on page 3 of the [Name] Report, Mr. [Name] states that "the net result is a fixed rate loan and the borrower is immune to changes in LIBOR." This is clearly not accurate. The net result from a cash flow standpoint, assuming that the relevant loan and swap terminate at the same time, may be the equivalent of a fixed rate loan. However, the ultimate results, especially if the swap terminates early, can be very different. Even if the Defendants had wanted a fixed rate loan--and to my knowledge they did not ask for one and would have been better off with the floating rate loan that was set forth in the Note signed by [Name] --this key difference was never really explained to them.

3. I have similar disagreements with the statement at the top of page 4 of the [Name] Report, which says "Because the borrower has entered into the swap transaction in conjunction with the loan, the borrower has converted the floating rate loan into a fixed rate loan."

4. The third sentence on page 5 of the [Name] Report states "If there are any disagreements over the terms of a transaction, it is usually in the confirmation process [that] the issues are resolved before both parties sign the documents." I agree with the statement in general. However, I would like to point out that in this case there was no "confirmation process". The Defendants had no idea that a swap transaction was even contemplated and were never told what terms [Name] had in mind; the Defendants certainly were never given any opportunity to disagree or negotiate any of the terms of the swap transaction that [Name] now claims was agreed to.

5. The last sentence in the first paragraph on page 5 of the [Name] Report states "Once the Confirmation is executed by both parties there should be no dispute over the terms or payments required to be made on the swap from either party." I would agree with the statement in general. However, I would like to point out once again that, to the best of my knowledge, [Name] never executed any confirmation.

6. I totally disagree with the last paragraph of the [Name] Report:

a. I disagree with the first sentence for the reasons set out in paragraphs 2 and 3 above.

b. I disagree with the second sentence because no confirmation was produced at closing or signed at closing (or ever) and the purported terms of such a confirmation were never disclosed at closing. To the best of my knowledge, the Defendants thought that they were entering into a floating rate loan that could be terminated at any time without penalty, as had been orally represented to them and as was set forth in the Note that was presented and signed at closing.

c. I disagree with the third sentence. To the extent that the documents cited laid out any risks, they did so in only the most perfunctory manner. The relevant risks certainly were not disclosed with the specificity and to the extent required by *Procter & Gamble* and industry standards that have been developed since *Procter & Gamble* was decided.

d. I disagree with the last sentence. No Confirmation Letter was presented or even discussed prior to or at closing. Even if at the last minute [Name] had mentioned a Confirmation, the Defendants had no idea what the purported terms were or of the specific risks involved in entering into such an arrangement.

7. SUMMARY

I have been a securities and finance attorney for close to 40 years. I have specialized in derivatives transactions for over 25 years. During the course of this time I have come to know (a) what is required in order for there to be a valid interest rate swap transaction between two parties and (b) what appropriate customs and practices, as dictated by relevant law, relating to one party's inducing another party into entering into such a transaction are. Based on these years of experience, it is my conclusion that (a) no interest rate swap transaction was entered into between [Name] and [Name] and, therefore, no money should be owed by [Name] to [Name] relating to the termination of any such transaction and (b) even had there been such an agreement, the manner in which [Name] induced [Name] to enter into such a transaction deviated significantly from industry customs and practice, as dictated by relevant law.

Craig A. Wolson