UNITED STATES COURT OF APPEALS
FOR DISTRICT OF COLUMBIA CIRCUIT

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FOR DISTRICT OF COLUMBIA CIRCUIT
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No. 08-7095

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

LIBERTY PROPERTY TRUST AND LIBERTY PROPERTY
LIMITED PARTNERSHIP,

Plaintiffs-Appellants

v.

REPUBLIC PROPERTIES CORPORATION, STEVEN A. GRIGG AND
RICHARD L. KRAMER,

Defendants-Defendants.

On Appeal from the United States District Court
for the District of Columbia

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SUMMARY OF ARGUMENT

In their opening brief, LPT and LPLP ("Plaintiffs") demonstrated that the District Court erred in ruling both that the RPLP Units issued to RPC were securities and that RPT had standing as a seller of the Units to pursue a securities fraud claim against RPC, Kramer, and Grigg (collectively "Defendants").

In response, Defendants twist the facts and misapply the law in arguing: (1) that the RPLP Units were not securities; (2) that RPT was not a seller of the Units; (3) that RPT and RPLP did not plead loss causation adequately; and (4) that RPT and RPLP did not plead scienter adequately.

In arguing that the RPLP Units issued to RPC were not securities, Defendants disregard the fact that RPC – the recipient of the Units at issue – had no rights under the Partnership Agreement to participate in the management of RPLP and did not, in fact, participate in the management of RPLP. Instead, in an attempt to get the RPLP Units outside of the definition of securities under the test established by *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), Defendants focus exclusively on Grigg and Kramer's – RPC's owners – role in RPT (not RPLP). Looking beyond RPC to its owners, however, is improper.

RPC, not Grigg and Kramer, was the limited partner who received the RPLP Units at issue. RPC is a distinct legal entity, and none of Kramer's and Grigg's rights with respect to RPT derived from their status as owners of RPC. None of

the cases relied upon by Defendants support piercing RPC's corporate veil for its own benefit (and the benefit of Grigg and Kramer) to allow Defendants to escape the reach of the federal securities laws. Indeed, until faced with this litigation, Defendants had treated the RPLP Units as securities, which treatment is consistent with the industry's, commentators', and the SEC's treatment of REIT operating partnership units as securities.

Defendants' argument that RPT was not a seller of the Units for purposes of the Exchange Act is similarly untenable. It relies on the inconsistent application of the term "seller" (1) for purposes of the Exchange Act and the Securities Act of 1933 and (2) depending on whether the purported seller is a plaintiff or defendant in an action for securities fraud.

Defendants also raise two arguments they made to the Court below: they contend that the allegations regarding loss causation and scienter are insufficient. Both arguments should be rejected by this Court.

With respect to loss causation, Defendants offer a series of confusing arguments in support of their position that the Amended Complaint did not allege loss causation adequately. The analysis, however, is much simpler than Defendants' claim. In sum, RPT and RPLP's loss caused by Defendants' security fraud is the difference between the value of the Units issued to RPC – approximately $1.2 million – and the *true* value of the Professional Services

Agreement at the time it was assigned to RPLP – $0. RPT and RPLP also are entitled to recover any profits made by Defendants in the subsequent sale of the Units to LPLP in connection with LPT's acquisition of RPT, as well as benefit of the bargain damages.

Defendants' argument regarding scienter is based on two remarkable assertions: (1) payment to a sitting governmental official who is actively voting on a contract is not material to the assignee of that contract; and (2) Defendants cannot be held liable for securities fraud because they have not been accused of criminal acts. As recognized by the District Court, Defendants, two experienced commercial real estate professionals and their company, cannot credibly argue that Plaintiffs did not plead facts giving rise to a strong inference that Defendants were at least reckless in failing to disclose that they were making monthly payments to a sitting government official who was voting on the Professional Services Agreement that RPC assigned to RPLP in exchange for RPLP Units.

ARGUMENT

I. <u>THE RPLP UNITS WERE SECURITIES</u>

Defendants argue that the RPLP Units issued to RPC were not securities under the test set forth by the Supreme Court in *SEC v. W.J. Howey Co.,* 328 U.S. 293 (1946). (Def. Brief at 20-30.) Defendants acknowledge that the issue of whether the RPLP Units were securities hinges on the third prong of the *Howey* standard – whether RPC, in making its investment in RPLP, expected to benefit predominantly from the efforts of others, or whether RPC expected to participate in the management of RPLP. *See Id.* at 298-99; *SEC v. Life Partners, Inc.* 87 F.3d 536, 545 (D.C. Circuit 1996); (Def. Br. at 22). In arguing that the RPLP Units were not securities, however, Defendants mischaracterize the facts of the transaction and misconstrue the applicable legal standards.

A. The Partnership Agreement Prohibited RPC From Participating in the Management of RPLP

The first step in the application of the *Howey* test and the analysis of economic realities surrounding RPC's limited partnership interest in RPLP is to inquire into the "***legal*** rights and powers enjoyed by [RPC]." *Steinhardt Group, Inc. v. Citicorp,* 126 F.3d 144, 153 (3d Cir. 1997) (emphasis added). Here,

Defendants do not even address the terms of the Partnership Agreement,[1] which provided RPC with no control over the affairs of RPT.

The Partnership Agreement charged the ***general partner*** – RPT – with exclusive management and control of RPLP. Partnership Agreement at § 7.1. The Partnership Agreement explicitly precluded limited partners, including RPC, from participating in RPLP's management:

> ***No Limited Partner or Assignee*** (other than the General Partner, any of its Affiliates, or any officer, director, employee, partner, agent or trustee of the General Partner, the Partnership of any of their Affiliates, ***in their capacity as such***) ***shall take part in the operation, management or control . . . of the Partnership's business***, transact any business in the Partnership's name or have any power to sign documents for or otherwise bind the Partnership.

[1] Defendants argue that the Partnership Agreement was not part of the record below and therefore could not be considered by the District Court. (Def. Br. at 32-33.) To the contrary, the Partnership Agreement is incorporated by reference into the Development Contribution Agreement at Section 6.3, which was attached to the Amended Complaint. Therefore, the Partnership Agreement is part of the Development Contribution Agreement. *Air Line Pilots Ass'n, Int'l v. Delta Air Lines, Inc.*, 863 F.2d 87, 94 (D.C. Cir. 1988) ("It is generally held that 'when a document incorporates outside material by reference, the subject matter to which it refers becomes a part of the incorporating document just as if it were set out in full.'") (citations omitted). Accordingly, the Partnership Agreement properly was part of the record on the motions to dismiss and can be considered by this Court on appeal. *See Felder v. Johanns*, No. 06-910, 2007 U.S. Dist. LEXIS 38001 (D.D.C. May 25, 2007). In any event, the Amended Complaint alleges that RPT, as general partner, had the exclusive right and full authority and responsibility to manage RPLP's business. (JA-9.)

Partnership Agreement at § 8.2 (emphasis added). Because RPC had no 'legal rights and powers," as limited partner or otherwise, to participate in the management of RPLP's business, the Units purchased by RPC were securities.[2]

B. The Economic Realities Demonstrate That the Units Were Securities

Defendants cannot (and do not) argue that RPC enjoyed any legal rights or powers to manage RPLP. Instead, they ignore the Partnership Agreement and argue that the "economic realities" require the conclusion that the RPLP Units owned by RPC were not securities. (Def. Brief at 20, 24-27). The realities – economic and otherwise – however, dictate the opposite conclusion.

1. RPC, in Fact, Exercised No Control Over RPLP

Defendants' economic reality argument is based on the proposition that courts must look beyond the form of a transaction to determine whether a limited partner expected to participate in the management of the limited partnership. (Def.

[2] Defendants rely on the Supreme Court's decision in *United Hous. Found., Inc. v. Forman*, 421 U.S. 837 (1975) to support their argument that the terms of the Partnership Agreement are not material to the Court's decision as to whether the Units issued to RPC were securities. (Def. Br. at 32-33). *Forman,* however, stands merely for the proposition that the Court needs to look beyond the name on the document – *i.e.,* stock, partnership, etc. – to the substantive rights and interests granted thereby. *Id.* at 850 ("In holding that the name given to an instrument is not dispositive, we do not suggest that the name is wholly irrelevant to the decision whether it is a security."). Here, the Partnership Agreement's terms were consistent with those generally found in limited partnership agreements in that they did not grant RPC – or other limited partners – any rights to participate in the management of RPLP.

Br. at 20-30.) In support of this argument, Defendants do not claim that RPC – the limited partner – participated in the management of RPLP. Rather, Defendants ignore the reality that RPC (as a corporation), not Grigg or Kramer (as its owners), was the purchaser of the RPLP Units at issue in this case and the limited partner on which the analysis must focus. Defendants' entire argument focuses not on RPC, but on the ability that Grigg and Kramer had to "influence the success of [RPC's] investment" through their roles in RPT (not RPLP).[3] (Def. Br. at 24-30.)

Looking beyond RPC to Kramer and Grigg, however, is improper. RPC had no authority to control RPLP's business and did not, in fact, exercise any control over RPLP's business. Moreover, though Kramer and Grigg stood on both sides of the transaction as owners of RPC and Board members of RPT, none of the entities – RPC, RPT, or RPLP – stood on both sides of the transaction. Kramer and Grigg were not appointed to RPT's Board by RPC, nor did they participate in the management of RPT as designees of RPC. Their roles as members of RPT's Board and, in the case of Grigg, RPT's President and Chief Development Officer, were wholly separate and independent from any ownership interest that they had in RPC and involved different and sometimes competing duties. Any control that Kramer

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[3] As noted in LPT and LPLP's opening brief, Kramer and Grigg did not have the authority to control the affairs of RPLP. Rather, they were involved with RPT as two of RPT's seven board members, and in the case of Grigg, as RPT's President and Chief Development Officer. RPT, not Kramer or Grigg, was RPLP's sole

and Grigg had over RPLP by virtue of their roles in RPT (two votes of seven on RPT's Board) cannot be attributed back to RPC. Simply put, RPC was nothing more than a passive investor in RPLP with no authority – under the Partnership Agreement or otherwise – to participate in the management of RPLP.

None of the cases cited by Defendants support the lynchpin of their argument: that it is appropriate to disregard RPC's existence as a distinct corporate entity in determining whether the RPLP Units issued to RPC were securities. To the contrary, unlike RPC – which had no management authority over RPLP (or RPT) – the limited partners in the cases relied upon by Defendants either participated in the management of the limited partnership directly or had some **legal right** to participate in or influence the management of the limited partnership's general partner.[4]

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general partner. Equating Grigg and Kramer with RPT is a second improper step required to support Defendants' argument that the RPLP Units were not securities.

[4] *See Steinhard Group*, 126 F.3d at 154 (not securities because partnership agreement provided limited partner with pervasive control over the management of the limited partnership); *Maritan v. Birmingham Props.*, 875 F.2d 1451, 1458-59 (10th Cir. 1989) (not securities where limited partner had unfettered access to information, had the implied power under the partnership agreement to "consult, disapprove, and otherwise participate in the ongoing development" of the partnership's business, and did, in fact participate directly in the affairs of the limited partnership); *Frazier v. Manson*, 651 F.2d 1078 (5th Cir. 1981) (not securities where (1) the limited partner was one of two partners in general partner of the limited partnership, and (2) where limited partner expected to be involved directly in the management of the limited partnership); *Kravco, Inc. v. Rodamco N. Am., N.V.*, No. 00-0272, 2000 U.S. Dist. LEXIS 17953, at *20-23 (E.D. Pa. Dec. 13, 2000) (not securities because limited partners had contractual right to appoint

Unlike the cases relied upon by Defendants, RPC: (1) did not have the right to participate in RPLP's business; (2) did not, in fact, participate in RPLP's business; (3) did not have the right to participate in the business of RPLP's general partner, RPT, either through the appointment of management or otherwise; and, (4) did not, in fact, participate in RPT's business. Indeed, RPC had no ability – ***in any capacity*** – to assert influence or control over RPLP. That Grigg and Kramer were owners of RPC does not alter the analysis. *Cf. U.S. ex rel. Siewick v. Jamieson Sci. & Eng'g, Inc.,* 322 F.3d 738, 740 (D.C. Cir. 2003) (declining to pierce corporate veil and recognizing that a corporation is a distinct entity from its shareholders and corporate officers, even when an individual has a significant ownership interest in the corporation and substantially controls its actions).

For reasons set forth above, the RPLP Units issued to RPC were securities and this Court should reverse the decisions of the District Court. At a minimum, the District Court's decision should be reversed and the case remanded to resolve issues of fact regarding RPC's role in the management of RPLP. *See, e.g., SEC v.*

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half of the members of the general partner's board); *David v. L.A. Presidential Mgmt. II, L.P.*, No. 98-6556, 2000 WL 1207157, at *4 (E.D. Pa. August 22, 2000) (not securities where one of the limited partners "participated in all major decisions and managed the property for a year following the creation of the limited partnership"); *Bamco 18 v. Reeves*, 675 F. Supp. 826, 830-31 (S.D.N.Y. 1987) (not securities where limited partner was sole true limited partner, owned 60% interest in the partnership, and participated in the partnership's business); *Darrah v. Garrett*, No. 83-424, 1984 WL 2422 (N.D. Ohio Mar. 14, 1984) (not securities

SG Ltd., 265 F.3d 42 (1st Cir. 2001) (reversing trial court's dismissal of claims on 12(b)(6) motion, and holding that determining whether a particular investment was a security required fact intensive analysis and was not appropriately decided on a motion to dismiss).

2. RPLP Units Were the Economic Equivalents of RPT Shares

Defendants argue that the economic equivalence between the RPT shares and RPLP Units is irrelevant to the analysis. (Def. Br. at 33-34.) This argument misses its mark. The equivalence does not rest on a one-for-one redemption basis, as Defendants argue, but on the fact that the value of the RPLP Units was based entirely on and derived from the value of the publicly traded REIT shares (whether one-for-one, two-for-one, or some other ratio). Moreover, that RPT could elect to cash out limited partners instead of converting Units to shares is beside the point. Whether cashing out or converting, the Unit holders would receive a value based exclusively on the value of the RPT shares at the time of the conversion/payment.

Perhaps more fundamentally, Defendants fail to acknowledge the basic UPREIT structure, the manner in which an UPREIT conducts business, and the purpose behind offering different types of securities to different investors. RPT and RPLP were part of one operating REIT. The two-tiered entity structure was

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where limited partners managed corporation on which limited partner depended exclusively for its profitability).

developed to provide two different mechanisms by which investors could invest in the REIT – cash for shares or property for Units. Not only was the value of the RPLP Units tied directly to the value of the RPT shares, the RPLP Units also were similar to the RPT publicly traded shares in that ownership of either or both did not provide the investor with any control over the day to day operations of RPT or RPLP.[5]

The similarities between RPT shares and RPLP Units – as well as the treatment of RPLP Units as securities, and the industry's, commentators', and SEC's treatment of operating partnership units as securities[6] – are significant because, as acknowledged by the Supreme Court, Congress "sought to define 'the term 'security' in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security.'" *Forman*, 421 U.S. at 847-48 (*quoting* H. R. Rep. No. 73-85, at 11 (1933)); *see also Ballard & Cordell Corp. v. Zoller & Danneberg Exploration, Ltd.*, 544 F.2d 1059, 1063 (10th Cir. 1976) ("in determining the existence of a 'security' the court should apply a flexible rather

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[5] Defendants' argument to the contrary – that limited partners in RPLP had "an active role in the management of the operating partnership" – is disingenuous. Any role that a limited partner had in the management of the RPT or RPLP (and RPC did not) derived no more from its status as a limited partner than a shareholder's role in the management derived from its status as a shareholder.

[6] All of these arguments are addressed fully in LPT and LPLP's opening brief and are not repeated here. (Pl. Br. at 15-17, 25-29.)

than a static principle . . ."). The RPLP Units issued to RPC were securities under the *Howey* test and also fell within the commercial world's ordinary concept of a security. Therefore, this Court should reverse the District Court's holding that the Units were not securities.

II. RPT WAS A "SELLER" OF THE RPLP UNITS

Defendants' argument that RPT was not the seller of the RPLP Units rests on the proposition that a seller of securities is defined differently for purposes of Section 12 of the Securities Act of 1933 than for purposes of Section 10(b) of the Exchange Act. Recognizing that the term "seller" can include the general partner of a limited partnership under Section 12 of the Securities Act (which also deals with misleading statements made in connection with the sale of securities), Defendants are forced to make the baseless argument that term "seller" means something different under Section 10(b) of the Exchange Act. (Def. Br. at 53). As the Court noted in *Allard v. Arthur Andersen & Co. (USA)*, 924 F. Supp. 488, 495-96 (S.D.N.Y. 1996), however, there is no basis for this distinction. *See also Grubb v. FDIC*, 868 F.2d 1151 (10th Cir. 1989) (holding that strict application of *Birnbaum* rule relied upon by Defendants is improper in complex securities transactions.)

The definition of the term seller also cannot depend, as Defendants argue, on the alleged seller's role in the case – i.e., under Defendants' rationale, RPT could

be a seller if it was defending an action for securities fraud brought by RPC but not if, as here, it chose to pursue an action for securities fraud. (*See* Def. Br. at 53.) Surely, Congress, in drafting the Securities Act and the Exchange Act, could not have intended such an arbitrary and inconsistent application of the term seller, nor could it have intended the uncertainty that would result therefrom. Here, the relationship between RPT and RPLP, RPT's control over RPLP, and RPT's role in the issuance of Units to RPC all support RPT's standing as a seller of the RPLP Units. (See JA-60-62.)

III. RPT AND RPLP ADEQUATELY PLED LOSS CAUSATION

Defendants dedicate a substantial portion of their brief to the argument that RPT and RPLP did not plead loss causation adequately. (Def. Br. at 37-47.) Defendants' arguments in this regard are confusing, at best, and include a substantial amount of irrelevant facts and law. (*E.g.*, *Id.* at 43-44 (stating that transaction causation – *i.e.,* RPT and RPLP's reliance on Defendants' fraud – is not the same as loss causation, an unremarkable proposition that is irrelevant to the analysis here).)

The analysis is not as cumbersome and complex as Defendants make it out to be, and RPT and RPLP adequately pled loss causation. The recovery of damages for a Section 10(b) claim is governed by § 28(a) of the Exchange Act, which provides defrauded parties the right to recover "actual damages." 15 U.S.C.

§ 78bb. The Supreme Court has defined "actual damages" generally to mean the "out-of-pocket" damages – *i.e.,* the difference between the price paid or received and the true value at the time of purchase. *Affiliated Ute Citizens of Utah v. United States,* 406 U.S. 128, 155 (1972).

In a "typical" securities fraud case, purchasers of securities bring an action for fraud against the seller alleging that the seller defrauded the purchasers into purchasing the securities at an inflated price based on a fraudulent representation or omission. Once the fraud is disclosed, the value of the securities drop, and the purchasers' out-of-pocket loss is the difference between what they paid and what they would have paid had they known the truth – *i.e.,* the true value.

In this case, RPT and RPLP were the sellers, not the purchasers, of the securities. Therefore their out of pocket damages are the value of the Units issued for the Professional Services Agreement – approximately $1.2 million at the time of issuance – less the true value of the Professional Services Agreement at the time it was assigned to the REIT. Here, as evidenced by the termination of the Professional Services Agreement based on the disclosure of the Defendants' fraud, the true value of the Agreement was $0 at the time it was assigned to the REIT. Therefore, the compensable loss caused by Defendants' fraud was at least $1.2 million.

In addition to their out-of-pocket loss, LPT and LPLP are entitled to recover from Defendants any profit Defendants received when they resold sold the Units to LPT/LPLP in connection with LPT's acquisition of RPT. *See, e.g., Robertson v. White,* 81 F.3d 752, 758 (8th Cir. 1996) (recognizing that when a buyer has defrauded a seller into selling securities, and the buyer then resells the shares for a profit, the defrauded seller can recover the profit).[7] Finally, benefit of the bargain damages also are appropriate in this case.); *Osofsky v. Zipf*, 645 F.2d 107, 112-15 (2d Cir. 1981) (noting that damages sustained by a defrauded buyer of securities are more speculative and thus different from the damages of a defrauded seller who does not get what he was promised, and allowing plaintiff to proceed on benefit of the bargain damages).

The loss causation analysis in this case is as simple as set forth above; however, LPT and LPLP respond to each of Defendants' arguments in the sections below.

A. RPT and RPLP Adequately Alleged Loss Causation Under *Dura Pharmaceuticals, Inc. v. Broudo*

In *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336 (2005) the Supreme Court set forth the following standard for pleading loss causation:

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[7] LPT acquired RPT after the filing of the Amended Complaint. Therefore, this category of damages, though clearly recoverable now, was not included in the Amended Complaint or the parties briefing in the District Court.

> We concede that the Federal Rules of Civil Procedure require only "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(2). And we assume, at least for argument's sake, that neither the Rules nor the securities statutes impose any special further requirement in respect to pleading proximate causation or economic loss. But even so, the "short and plain statement" must provide the defendant with "fair notice of what the plaintiff's claim is and the grounds upon which it rests." *Conley v. Gibson*, 355 U.S. 41, 47 (1957)

Id. at 346. In *Dura*, the Supreme Court reversed the Ninth Circuit's holding that loss causation was pled sufficiently by mere allegations that the stock "price on the date of purchase was inflated because of the misrepresentation," *id.* at 342, and further held that the plaintiffs had not alleged loss causation adequately because they did not include facts alleging that the "share price fell significantly after the truth became known." *Id.* at 347. The Supreme Court noted that, in a typical securities fraud case – *i.e.,* a class action brought by the purchasers of securities based on a drop in value of the share price after purchase – discovery and disclosure of securities fraud is normally but one of a "tangle of factors" affecting the stock price, and that paying a higher purchase price will therefore only "*sometimes* play a role in bringing about a future loss." *Id.* at 343 (emphasis in original). Accordingly, the Court in *Dura* held that plaintiffs in a securities fraud action must allege and prove the traditional common law elements of loss causation; it did not impose a higher pleading standard on securities fraud cases. *Id.* at 346-47.

Though pleading loss causation can prove difficult for plaintiffs in a typical securities fraud action, none on the pleading problems addressed in *Dura* present themselves here. *See id.* at 347 ("We concede that ordinary pleading rules are not meant to impose great burden upon a plaintiff."). RPT and RPLP alleged that they were defrauded by Defendants' failure to disclose that Defendants actively were paying a sitting public official who was voting on Defendants' contracts, including the Professional Services Agreement that RPC assigned to RPLP in exchange for RPLP Units (transaction causation). RPT and RPLP further alleged that, as a direct result of the disclosure of Defendants' payments to a city official, RPT and RPLP lost the Professional Services Agreement and the benefits thereof. (JA-23, 77). Specifically, RPT and RPLP alleged that, "**In May 2006, as a result of the improper and undisclosed payments made by RPC to Liberti, the City and the Community Redevelopment Agency provided notice to RPT/Republic WPB of their intent to terminate the Professional Services Agreement.**" (*Id.* (emphasis added).)[8]

At the moment the City informed RPT and RPLP that, because of Defendants' undisclosed payments to a city official, the City would not continue with the Professional Services Agreement, RPT and RPLP's out-of-pocket loss

[8] To eliminate its potential exposure to the City for the acts of the Defendants, the REIT later assigned its rights in the Professional Services Agreement back to the City. (JA-24, 80.)

was the difference between the fair value of the Units issued to RPC – approximately $1.2 million – and the fair value of the Professional Services Agreement received in exchange for the Units – $0, because RPT and RPLP would not realize any benefit from the Professional Services Agreement. (*See* Def. Br. at 37-38 (setting forth the typical measure of damages for a defrauded seller of securities).)

B. RPT and RPLP Suffered a Loss as a Result of Defendants' Fraud

This is not a case where a parent is seeking to recover for damages suffered *soley* by its subsidiary. The internal structure of the REIT and the particular entity through which RPT and RPLP chose to perform the Professional Services Agreement do not change the fact that RPT and RPLP suffered the loss caused by Defendants' fraud. RPT caused RPLP to enter into the Development Contribution Agreement because the REIT (RPT, RPLP and all of its subsidiaries) expected to reap the benefits of the Professional Services Agreement. RPLP is the party that issued the Units to RPC in exchange for the Professional Services Agreement, and all parties involved, including Defendants, knew that RPT and RPLP were the parties (1) that were intended to benefit from the assignment of the Professional Services Agreement to the REIT and (2) the parties that stood to lose from a loss of the Professional Services Agreement, including the loss suffered as a result of Defendants' fraud. Accordingly, RPT and RPLP suffered the loss at issue and

have standing to assert their securities fraud claims.[9] *Cf. Grubb v. FDIC*, 868 F.2d 1151, 1161 – 62 (10th Cir. 1989) (determining individual who establishes a holding company to purchase stock in a complex transaction may be an "actual party at risk" for determining damages); *Bellomo v. Penn. Life Co.,* 488 F. Supp. 744, 746 (S.D.N.Y. 1980) (holding where subsidiary is created by the parent "to carry on business on its behalf, there is no basis for distinguishing between the business of the parent and the business of the subsidiaries.").

Adopting Defendants' argument would lead to the untenable result that insiders of REITs and other similarly structured entities could defraud the company with impunity. To enjoy the tax benefits derived from structuring a business as a REIT, the REIT must operate certain aspects of its business through subsidiaries. Under Defendants' theory of loss, insiders could take advantage of this requirement and dump their bad properties, contracts, etc., on the REIT's subsididaries in exchange for valuable shares of the REIT's operating partnership. Upon disclosure of their fraud, the insiders would be able to point to the very structure that they created to insulate themselves from liability. The fraudsters would retain the benefits of their fraud and the REIT would be stuck with the losses. Indeed, that is the precise position of the parties to this litigation, with

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[9] The cases relied upon by the Defendants do not require otherwise. They stand at most for the proposition that, in certain factual circumstances, a parent corporation

RPC, Grigg, and Kramer over $1.2 million richer and RPT and RPLP stuck with the worthless Professional Services Agreement and the fallout therefrom.

C. The Damages Sought Are Recoverable Under Section 10(b)

Defendants argue that the damages sought by RPT and RPLP are not recoverable on a securities fraud claim. As an initial matter, RPT and RPLP brought numerous claims against Defendants in addition to the securities fraud claims. Each of these claims includes different categories and amounts of damages. As Defendants well know, RPT and RPLP represented to the District Court that they were not seeking recovery for all of those categories of damages on their securities fraud claims. (Pls.' Mem. Opp'n Grigg Mot. to Dismiss at n. 9.) The categories of damages that RPT and RPLP seek to recover on these claims – out-of-pocket loss and benefit of the bargain damages – are recoverable.

First, as Defendants acknowledge, the typical measure of seller damages in a securities fraud action is "the difference between the fair market value of the security and the fair market value of the consideration received for it." (Def. Br. at 37-38). As discussed above, the fair market value of the RPLP Units at the time of their issuance was approximately $1.2 million. As a result of Defendants' fraud, the City of West Palm Beach refused to continue the City Center project with RPT/RPLP as the developer, thus rendering the Professional Services Agreement

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may properly be prevented from recovering for harm caused solely to its

worthless. Therefore, RPT and RPLP's out-of-pocket loss was at least $1.2 million.

Second, Defendants acknowledge that, in appropriate circumstances, plaintiffs in a securities fraud action may recover benefit of the bargain damages, but argue that such damages are not appropriate here. (Def. Br. at n. 41.) In support of their argument, Defendants rely on the "general rule" that limits securities fraud plaintiffs to out-of-pocket losses. (Def. Brief at 40-41; n. 28.) Defendants omit from their brief that the cases upon which they rely all involve claims where a purchaser of securities sought to recover for the appreciation in the price of the security from the date of purchase to the date that the fraud was disclosed. Specifically, as set forth in the cases relied upon by Defendants, the out-of-pocket limitation "measures the damages recoverable by an individual who because of fraud or misrepresentation has *been injured by market transactions in an actively traded stock.*" *Wool v. Tandem Computers Inc.*, 818 F.2d 1433, 1437 (9th Cir. 1987) (emphasis added).

RPT and RPLP's benefit of the bargain damages do not fall within the limited exclusion relied upon by Defendants. Outside of the context of damages awarded to purchasers of actively traded stock, courts have, in appropriate circumstances, permitted securities fraud plaintiffs to recover benefit of the bargain

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subsidiary.

damages under 10(b)(5). *See McMahon & Co. v. Wherehouse Entertainment*, 65 F.3d 1044, 1051 (2d Cir. 1995) (affirming district courts order determining that benefit-of-the-bargain damages are available on Section 10(b) claims); *Osofsky*, 645 F.2d at 112-15; *Zeller v. Bogue Elec. Mfg. Corp.*, 476 F.2d 795, 803 (2d Cir. 1973) (allowing recovery of lost profits that would have been earned but for the defendants' fraud).

Whether LPT and LPLP can prove their benefit of the bargain damages with the requisite level of certainty is not an issue that could have been decided on Defendants' motion to dismiss, and therefore it does not provide a basis upon which to affirm dismissal. In any event, even if benefit of the bargain damages are not recoverable, LPT and LPLP are entitled to recover out-of-pocket losses of at least $1.2 million.

D. Defendants' Actions Directly and Proximately Caused the Damages Sought

This not a case of a defendant "incorrectly predicting the future," nor is this a case that involves a complex causal chain in which "some unforeseen event occurred which rendered the investment worthless." (Def. Br. at 44-45.) Indeed, the causal chain between Defendants' fraud and the damages caused thereby is simple and clear, and the end result was the obvious consequence of the fraud:

> (1) *The Liberti Relationship.* RPC, with Grigg's authorization and Kramer's knowledge, paid Raymond Liberti, a sitting West Palm Beach City Commissioner and a member of the West Palm Beach

Community Redevelopment Agency, monthly payments of $5,000 and later $8,000 between November 2004 and May 2006. While RPC was paying him, Liberti voted for the benefit of Defendants on several matters that came before the City Commission and Community Redevelopment Agency, including amendments to the Professional Services Agreement and the assignment of the Professional Services Agreement to the REIT.

(2) *The Fraud.* In connection with the Development Contribution Agreement under which RPC assigned to RPLP its right, title, and interest in the Professional Services Agreement, Defendants failed to disclose to RPT or RPLP that RPC was paying Liberti, who had and would continue to cast votes for the benefit of Defendants and, after the assignment, RPT and RPLP. In connection with the Development Contribution Agreement, RPT caused RPLP to issue 100,234 Units to RPLP, which at the time were valued at approximately $1.2 million.

(3) *Transaction Causation.* Had RPT and RPLP known of RPC's payments to Liberti, RPT would not have caused RPLP to enter into the Development Contribution Agreement.

(4) *Disclosure of Fraud.* RPC's payments to Liberti were publicly exposed in May 2006, at which time RPT and RPLP also learned of the payments (the disclosure of the fraud).

(5) *Loss Causation.* As a direct and proximate result of RPC's payments to Liberti (and the disclosure thereof), the Professional Services Agreement was rendered worthless and RPT and RPLP lost the Agreement.

Defendants' argument that they could not have predicted the manner in which the fraud would be disclosed is frivolous and irrelevant to the inquiry. Fraudulent actors never intend their fraud to be exposed. Indeed, the primary goal of fraud and an essential element of securities fraud is concealment of the fraudulent act. Once the fraud is revealed, the damage is done and defrauded party has a right to recover its losses.

Here, Defendants had an affirmative duty to disclose to RPT and RPLP the fact that RPC was paying Liberti, so that RPT and RPLP could appreciate the potential (and logical) consequences of the payments' disclosure – *i.e.,* termination of the Professional Services Agreement. *See, e.g., In re Indep. Energy Holdings PLC Sec. Litig.,* 154 F. Supp 2d 741, 760 (S.D.N.Y. 2001) (holding that securities laws "certainly require disclosure of information that would permit an investor to appreciate the risk that future sanctions may arise"). The manner in which Defendants' fraud was exposed was meaningless because their fraud was the direct and proximate cause of RPT and RPLP's losses.

IV. <u>RPT AND RPLP PLED ALLEGATIONS GIVING RISE TO A STRONG INFERENCE OF SCIENTER</u>

Defendants argue that RPT and RPLP did not plead adequate facts from which a strong inference of scienter could be inferred. Defendants' support for this argument is essentially twofold: (1) that Defendants had no reason to believe that RPT and RPLP would be interested to know that, pursuant to an ongoing relationship approved by Grigg and Kramer, RPC had made monthly payments of $5,000 and later $8,000 to Raymond Liberti, a City of West Palm Beach Commissioner and a member of the City's Community Redevelopment Agency, while he voted for the benefit of RPC on the Professional Services Agreement that RPC assigned to RPLP (Def. Br. at 48-49); and (2) that it is "impossible to justify a finding of scienter – which requires intentional wrongdoing or extreme

recklessness – based on" Defendants', two seasoned real estate developers and their company's, failure to disclose that they were paying a government official while he voted on their contracts with the City. (Def. Br. at 49-50). To the contrary, it is Defendants' "innocent" inference that stretches the bounds of credibility.

Defendants also argue that scienter cannot be established because RPT and RPLP did not plead that the payments to Liberti were criminal. This argument is frivolous. Defendants' payments to Liberti do not need to be criminal in order for the nondisclosure of those payments to be actionable. In determining whether RPT and RPLP adequately pled scienter, the Court must ask, "When the allegations are accepted as true and taken collectively, would a reasonable person deem the inference of scienter at least as strong as any opposing inference?" *Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 127 S.Ct. 2499, 2511 (2007). Moreover, "the inquiry is whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard. *Id.* at 2510.

As recognized by Defendants, either intentional wrongdoing or extreme recklessness is sufficient to satisfy this standard. (Def. Br. at 47.) *See SEC v. Steadman,* 967 F.2d 636, 641 (D.C. Cir. 1992). In addition, "motive can be a

relevant consideration, and personal financial gain may weigh heavily in favor of a scienter inference." *Tellabs,* 127 S. Ct. at 2511.

RPT and RPLP amply pled extreme recklessness, motive, and financial gain on the part of Defendants. In sum, RPC, with Grigg's authorization and Kramer's knowledge, made monthly payments of $5,000 and later $8,000 to Liberti, all while Liberti was voting and otherwise acting for the benefit of RPC's role in, among other things, the City Center project and the Professional Services Agreement. The details of these payments, votes, and other acts are set forth in detail in Paragraphs 23 through 70 of the Amended Complaint. (JA-14 - 22.) Despite the ongoing nature of their relationship with Liberti, and despite the fact that Liberti had voted on the Professional Services Agreement while receiving payments, Defendants failed to disclose any of this information to RPT and RPLP in connection with the Development Contribution Agreement and assignment of the Professional Services Agreement to RPLP. (JA-25, JA-29.) Moreover, RPC represented and warranted the validity of the Professional Services Agreement, which, among other things, included representations that RPC would conduct its business with the City in an above-board manner and free from conflicts. (JA-26.) Finally, by assigning the Professional Services Agreement to RPLP, RPC – and as its owners, Kramer and Grigg – were able to rid themselves of the tainted

Professional Services Agreement and obtain RPLP Units worth approximately $1.2 million. (JA-12 – 14, JA-32 - 34.)

Presented with these facts, on the one hand, and Defendants' characterization thereof, on the other, the District Court properly concluded that:

> Taken together, [RPT and RPLP's] allegations give rise to a credible inference of fraudulent intent as to Grigg and Kramer. As discussed above, information concerning RPC's pecuniary relationship with Liberti was decidedly material to RPLP's decision to accept the [Professional] Services Agreement as consideration for the [RPLP] [U]nits. Grigg and Kramer, both experienced entrepreneurs, were keenly aware of this information and should reasonably have recognized its materiality. On these facts, **it seems extremely unlikely that their failure to disclose was attributable to mere negligence. Instead, [RPT and RPLP's] allegations suggest [D]efendants intentionally concealed RPC's payments to Liberti because they feared RPLP would otherwise perceive the offered consideration as the product of bribery and decline to issue [RPLP] [U]nits for it.**
>
> . . .
>
> [Defendants'] generous characterization of events is less than compelling. Grigg and Kramer may well have orchestrated the consulting agreement with Liberti in good faith, and all transactions may, in fact, have been above-board. They may have genuinely believed RPLP and the REIT stood to profit from the [Professional] Services Agreement's assignment. **But to claim RPC's payments to Liberti "did not raise any red flags" defies common sense. Whether or not it was indeed improper, RPC's pecuniary relationship with a voting [Community Redevelopment] Agency member created an *obvious* appearance of impropriety. That RPC paid Liberti by check rather than by a briefcase stuffed with non-sequential bills perhaps lessens but does not eliminate the taint of corruption that necessarily attaches to such an interested transaction. The Court does not find persuasive the inference that Grigg and Kramer, sophisticated businessmen, naively**

> **believed that RPC's arrangement with Liberti would be of no interest to a potential assignee for consideration of the [Professional] Services Agreement.**

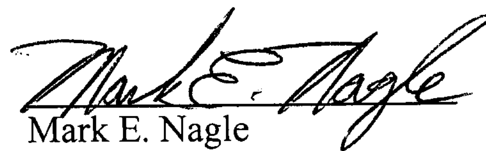
(Pls.' Mem. Opp'n Mot. to Dismiss at 19-21 (bold added, italics in original).) As reflected by the District Court's decision, RPT and RPLP's allegations, "accepted as true and taken collectively," would lead a reasonable person to "deem the inference of scienter at least as strong as any opposing inference." *Tellabs,* 127 S. Ct. at 2511. Therefore, the District Court did not err in holding that RPT and RPLP had pled allegations sufficient to raise a strong inference of scienter.

V. CONCLUSION

For the reasons set forth herein and in their opening brief, Liberty Property Trust and Liberty Property Limited Partnership respectfully request that the Court reverse the District Court's orders granting the motion to dismiss and denying the motion for reconsideration.

Dated: April 2, 2009

Respectfully submitted,



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No. 08-7095

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

LIBERTY PROPERTY TRUST AND LIBERTY PROPERTY
LIMITED PARTNERSHIP,

Plaintiffs-Appellants

V.

REPUBLIC PROPERTIES CORPORATION, STEVEN A. GRIGG AND
RICHARD L. KRAMER,

Defendants-Defendants.

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) and Circuit Rule 32(a) because this brief contains 6,162 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii) and Circuit Rule 32(a)(2).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word XP in Times New Roman 14.

Dated: April 2, 2009

Mark E. Nagle
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ADDENDUM

Statute — Addendum Page

15 U.S.C. § 78c(a)(10) i

15 U.S.C. § 78j ii

15 U.S.C. § 78c. Definitions and application

(a) Definitions. When used in this title, unless the context otherwise requires—

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(10) The term "security" means any note, stock, treasury stock, security future, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance, which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

***

15 U.S.C. § 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange--

(a)

(1) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(2) Paragraph (1) of this subsection shall not apply to security futures products.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [15 USCS § 78c note]), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rules promulgated under subsection (b) that prohibit fraud, manipulation, or insider trading (but not rules imposing or specifying reporting or recordkeeping requirements, procedures, or standards as prophylactic measures against fraud, manipulation, or insider trading), and judicial precedents decided under subsection (b) and rules promulgated thereunder that prohibit fraud, manipulation, or insider trading, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act [15 USCS § 78c note]) to the same extent as they apply to securities. Judicial precedents decided under section 17(a) of the Securities Act of 1933 [15 USCS § 77q(a)] and sections 9, 15, 16, 20, and 21A of this title [15 USCS §§ 78i, 78o, 78p, 78t, and 78u-1], and judicial precedents decided under applicable rules promulgated under such sections, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act [15 USCS § 78c note]) to the same extent as they apply to securities.

No. 08-7095

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LIMITED PARTNERSHIP,

Plaintiffs-Appellants

v.

REPUBLIC PROPERTIES CORPORATION, STEVEN A. GRIGG AND
RICHARD L. KRAMER,

Defendants-Defendants.

CERTIFICATE OF SERVICE

This is to certify that on April 2, 2009, I caused to be served by hand two copies of Reply Brief of Appellants on:

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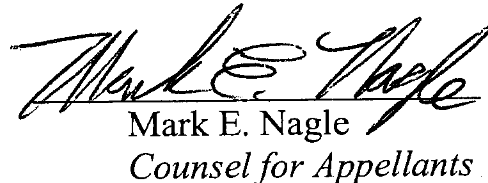
Dated: April 2, 2009



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