UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE CENTERLINE HOLDING COMPANY SECURITIES LITIGATION	**Consolidated C.A. No. 08-CV-00505 (SAS)**

DEFENDANTS' REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF THEIR MOTION TO DISMISS THE CONSOLIDATED CLASS ACTION COMPLAINT

Richard A. Rosen
Daniel J. Leffell
PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP
1285 Avenue of the Americas
New York, NY 10019-6064
Phone: (212) 373-3000
Fax: (212) 757-3990
rrosen@paulweiss.com

Attorneys for Marc D. Schnitzer and Robert L. Levy

Peter L. Simmons
FRIED, FRANK, HARRIS, SHRIVER & JACOBSON LLP
1 New York Plaza
New York, NY 10022
Tel: 212-859-8455
Fax: 212-859-4000
peter.simmons@friedfrank.com

Attorneys for Defendants Stephen M. Ross and Jeffrey T. Blau

Jennifer F. Beltrami
WOLFBLOCK LLP
250 Park Avenue
New York, NY 10177
Tel: 212-883-4955
Fax: 212-672-1155
jbeltrami@wolfblock.com

Attorneys for Centerline Holding Company

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

Page(s)

Page(s)

FEDERAL STATUTES AND REGULATIONS

Defendants Centerline Holding Company ("Centerline" or the "Company") and Marc D. Schnitzer, Robert L. Levy, Stephen M. Ross, and Jeff T. Blau (the "Individual Defendants") respectfully submit this reply memorandum of law in further support of their motion to dismiss the Consolidated Class Action Complaint For Violation of Federal Securities Laws (the "Complaint" or "Cplt."), with prejudice.

PRELIMINARY STATEMENT

Lead Plaintiff's memorandum ("Pl. Mem.") spills much ink refuting arguments that defendants have not advanced, while ignoring the key points on which defendants' motion is actually based.

First, defendants' brief established that no statute, regulation or case law imposed any duty to make advance disclosure of Centerline's active efforts to structure and negotiate a sale of its tax-exempt bond portfolio or of its discussions about raising equity through the sale of convertible preferred stock (the "TRCLP Investment"). The relevant SEC rules — as Lead Plaintiff is required to acknowledge — allow an issuer to refrain from advising the market of the possibility of such transactions, no matter how large or transformative they may be, until they are complete. Although Lead Plaintiff hurriedly acknowledges that the law permitted defendants to maintain silence on the subject of these potential transactions, even as they neared fruition, Lead Plaintiff fails to come to grips with — or even discuss — the necessary legal consequence of this element of the SEC's disclosure regime.

So long as defendants do not make an affirmative statement on the subject of these incipient plans or projects — *e.g.*, by denying that any such plans exist — they are free to continue to discuss their ordinary business plans, the results of operations, and other forward-looking projects, all without fear of securities law liability. Despite citing a mind-numbing litany of authorities for the boilerplate (and wholly unexceptionable) principle that an issuer cannot make misleading affirmative statements, Lead Plaintiff utterly fails to identify any such statement about defendants' plans or promises that were inconsistent with the new transactions they were striving to be able to announce at year end. (*See* pp. 7-11, *infra*.)

Second, Lead Plaintiff offers no persuasive response to our demonstration that, in light of the existence of the SEC Rules that specifically permit nondisclosure of such plans, the Complaint fails to allege with particularity that defendants' reliance on those rules to guide their behavior — and thus their failure to make the affirmative disclosures at issue in this lawsuit — was fraudulent or reckless. To be sure, Lead Plaintiff spends five pages arguing that defendants knew about these potential transactions well before they were disclosed, but that proposition is not in dispute; the issue is whether the defendants recklessly breached a known disclosure obligation with respect to what they knew. On that issue, Lead Plaintiff does not cite any authority finding *scienter* adequately pled where defendants had complied with applicable SEC disclosure requirements. Further, defendants previously established that the alleged fraudulent motive ascribed to certain defendants — to drive *down* the price of Centerline's stock of which they were all owners — makes no sense and in any event cannot explain an alleged fraud that supposedly *inflated* the stock price by *withholding* the very information expected to produce a stock price decline. And Lead Plaintiff does not even seriously attempt to explain how the alleged motive can be fitted to the alleged fraud. (*See* pp. 11-16, *infra*.)

Third, defendants showed that the Complaint does not adequately plead loss causation because it: (a) does not plead any corrective disclosure to support a finding of loss causation at any time before December 28, 2007; and (b) does not adequately plead facts establishing that the revelation of alleged fraud — as opposed to other announcements by Centerline on the same day

— caused the reduction in stock price on December 28, 2007. Lead Plaintiff does not rebut either point. (See pp. 16-17, *infra*.)

In sum, the Complaint does not state a claim for securities fraud and should be dismissed.[1]

ARGUMENT

I.
CENTERLINE DID NOT HAVE A DUTY TO DISCLOSE THE DECEMBER 2007 TRANSACTIONS BEFORE THEY WERE FINALIZED.

As shown in defendants' opening memorandum, no statute, regulation or case law imposed any duty to make advance disclosure of any of the matters at issue here before a definitive agreement existed. (Def. Mem. at 9-11.) Lead Plaintiff does not disagree, and does not dispute that Centerline complied with the SEC disclosure requirements by announcing the bond portfolio sale and the TRCLP Investment upon execution of the relevant agreements and not before. (*See* Pl. Mem. at 2.)

Yet Lead Plaintiff's claim cannot be squared with the necessary consequence of defendants' compliance with the disclosure requirements: so long as defendants did not make false statements about their planned transactions or projects (for instance, by denying an existing plan or intention), they were free to discuss their ordinary business plans, the results of operations, and other forward-looking projects. Although Lead Plaintiff *asserts* it has pled that "[d]efendants repeatedly led investors to believe that Centerline would retain its tax-exempt bond portfolio and continue paying substantial dividends which were largely tax-exempt for the

[1] Additionally, Lead Plaintiffs' claims against Messrs. Schnitzer, Levy, Ross, and Blau (the "Individual Defendants") under Section 20(a) should be dismissed because, as shown herein and in defendants' opening brief, no claim has been stated against either Centerline or the Individual Defendants under Section 10(b), and thus any derivative claim against the latter under Section 20(a) should be dismissed. (*See* Defendants' Memorandum ("Def. Mem.") at 34 n.31.) Lead Plaintiff does not dispute that a derivative claim under Section 20(a) cannot stand in the absence of a well pled primary claim.

foreseeable future" (Pl. Mem. at 1), the Complaint does *not* in fact allege any statement to that effect. To the contrary, the statements on which Lead Plaintiff bases its claim concern ordinary business plans, the results of operations, and other projects and were in most cases *required* in periodic reports under SEC rules. For example, Lead Plaintiff relies on a statement in Centerline's Form 10-k for 2006, that "we derive a large portion of our earnings by . . . investing in mortgage revenue bonds." (Pl. Ex. A at 1.) But Lead Plaintiff fails to mention that this statement was a necessary part of a discussion of "RISKS ASSOCIATED WITH THE PROPERTIES UNDERLYING OUR FINANCING PRODUCTS AND INVESTMENTS," which is required under SEC rules. (March 12, 2007 Centerline 10-K, *available at* http://www.secinfo.com/d18dZ5.ua.htm.) *See* 17 C.F.R. § 229.305(b)(1)(i)-(ii) ("To the extent material, describe . . . [t]he registrant's primary market risk exposures") (cross-referenced in SEC Form 10-K, Item 7). As previously pointed out, it cannot be that an issuer, by *complying* with such requirements, incurs a duty to make advance disclosures of possible future actions that are expressly *not* required under SEC rules. (*See* Def. Mem. at 8-14, 19.)

Lead Plaintiff cites no authority to the contrary, and the cases that Lead Plaintiff does cite have no bearing on this case.

First, many of the cases cited by Lead Plaintiff involved allegations that defendants had affirmatively *denied* an activity they were involved in, or were planning or conducting an activity contrary to the one disclosed. In *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988) (Pl. Mem. at 2), for instance, the plaintiff's allegations stemmed from statements made by defendants expressly *denying* engagement in merger negotiations at the very time defendants were in fact engaged in such negotiations. 485 U.S. at 227-28.[2] Here, Lead Plaintiff has not identified any statement denying that the Company would sell significant assets or raise equity, as announced on December 28, 2007.

Second, Lead Plaintiff points to cases involving allegations that defendants had failed to speak fully and truthfully about a *completed* transaction or existing facts. Thus, in *In re Bristol Myers Squibb Co. Securities Litigation*, 2008 WL 3884384, at *1, 9 (S.D.N.Y. Aug. 20, 2008) (Pl. Mem. at 7), the complaint alleged a failure to disclose that the issuer had previously agreed to "relinquish certain material legal rights under its settlement agreements with Apotex" or that it had already "entered into 'secret' oral side agreements related to the Apotex litigation."[3] Again,

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[2] *See also Caiola* v. *Citibank*, 295 F.3d 312, 318, 330-31 (2d Cir. 2002) (Pl. Mem. at 8 n.6) (because the company stated it would take a particular course of action, its failure to disclose that it was doing the opposite was actionable); *Caremark, Inc.* v. *Coram Healthcare Corp.*, 113 F.3d 645, 650 n.7 (7th Cir. 1997) (Pl. Mem. at 13) (company chose to represent its strategy as "focus[ed] on its 'core business' and to divest 'non-strategic businesses'" while intending to acquire a company engaged in a non-core business); *Ackerman* v. *Schwartz*, 947 F.2d 841, 843, 848 (7th Cir. 1991) (Pl. Mem. at 17) (defendant issued an opinion letter containing fictitious "facts" about investments and concluded the IRS would issue credits and deductions on the investments when in fact the "investments" being offered did not produce that result); *McMahan & Co.* v. *Wherehouse Entm't*, 900 F. 2d 576, 578 (2d Cir. 1990) (Pl. Mem. at 20) (plaintiffs alleged defendants represented in offering materials that a right was valuable, when in fact defendants were offering an illusory right); *In re MCI Worldcom, Inc. Sec. Litig.*, 93 F. Supp. 2d 276, 280, 281 (E.D.N.Y. 2000) (Pl. Mem. at 21 n.21) ("In response to a question regarding the significance of the registration of the 'skytelworldcom.com' MCI's spokesperson stated '[i]n this case, the action is not an indication of official company intention'" thereby falsely suggesting "that MCI had no intention to acquire SkyTel."); *In re Columbia Sec. Litig.*, 155 F.R.D. 466, 469, 479 (S.D.N.Y. 1994) (Pl. Mem. at 8 n.6) (issue of fact remained as to whether defendants falsely denied participation in merger negotiations).

[3] *See also In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 433, 454 (S.D.N.Y. 2005) (Pl. Mem. at 9) (failure to disclose company's present position as guarantor of loans used by a cruise line to purchase ships from the company was deemed actionable); *In re Xcel Energy, Inc.*, 286 F. Supp. 2d 1047, 1050, 1052, 1059 (D. Minn. 2003) (Pl. Mem. at 14-15 & n.15) (failure to disclose present existence of cross-default covenants with subsidiary in credit facilities – such that if subsidiary were downgraded to junk status, both subsidiary and parent company would be in default status, thus potentially affecting parent company's credit line – was deemed actionable); *In re Credit Suisse First Boston Corp. Sec. Litig.*, No. 97 Civ. 4760 (JGK), 1998 WL 734365, at

even Lead Plaintiff does not contend it has pled any failure to speak fully and truthfully about a *completed* transaction or existing facts.

Third, Lead Plaintiff also relies on cases involving allegations that defendants had made *predictions* about future events or expressed opinions that the defendant did not genuinely or reasonably believe, such as *Weiner* v. *Quaker Oats Co.*, 129 F.3d 310, 313-14 (3d Cir. 1997) (Pl. Mem. at 13) (defendants made firm predictions that debt-to-capitalization ratio “[f]or the future . . . will be in the upper-60 percent range” without disclosing that a future acquisition could “drive Quaker’s total debt-to-total capitalization ratio up and earnings growth down.”).[4] Here, yet again, there is no allegation that defendants made any predictions about future events or stated any opinions inconsistent with their genuine beliefs.

Fourth, Lead Plaintiff cites cases involving allegations that a defendant revealed *some*, but not all, material details *about a transaction*.[5] Here, there is no allegation of a selective

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*6 (S.D.N.Y. Oct 20, 1998) (Pl. Mem. at 8 n.6) (plaintiffs alleged failure to disclose a short position the company already had in stocks it had critiqued); *In re Par Pharm., Inc. Sec. Litig.*, 733 F. Supp. 668, 673, 677 (S.D.N.Y. 1990) (Pl. Mem. at 8 n.5) (Plaintiffs alleged actionable failure to disclose that bribery – as opposed to the (false) legitimate reason disclosed – was the reason defendant had obtained quick FDA approval).

[4] *See also Rubinstein* v. *Collins*, 20 F.3d 160, 162-3, 170 (5th Cir. 1994) (Pl. Mem. at 8 n.6) (defendants chose to make optimistic predictions about future yield of natural gas resource); *Lapin* v. *Goldman Sachs Group, Inc.*, 506 F. Supp. 2d 221 (S.D.N.Y. 2006) (*cited at* Pl. Mem. at 14 n.14) (“[o]ptimistic statements may be actionable upon a showing that the defendants did not genuinely or reasonably believe the positive opinions they touted”).

[5] *See Brumbaugh* v. *Wave Sys. Corp.*, 416 F. Supp 2d 239, 247, 249-50 (D. Mass 2006) (Pl. Mem. at 14 n.13) (company issued press statements that disclosed agreement with Intel Corporation but failed to disclose at that time that “the Intel deal was a non-exclusive licensing agreement with no minimum licensing requirements”); *In re Quintel Entm’t Inc. Sec. Litig.*, 72 F. Supp. 2d 283, 291-93 (S.D.N.Y. 1999) (Pl. Mem. at 14 n.13). (“Quintel ‘publicly hyped’ its ‘unique’ and ‘exciting’ partnership with AT&T, as well as its success in decreasing chargebacks; therefore there was a duty to disclose when Quintel received information that rendered that hype misleading.”; the information included data that the number of “chargebacks” – including “refunds, credits and uncollectible amounts” – Quintel was disclosing was “false and

disclosure about the bond portfolio sale, the 2008 dividend, or the TRCLP Investment. In this regard, Lead Plaintiff's reliance on *In re Time Warner Securities Litigation*, 9 F.3d 259 (2d Cir. 1993) (Pl. Mem. at 12-13), is especially telling. As quoted in Lead Plaintiff's memorandum, *Time Warner* held that there may be a duty to make further disclosure "when a corporation is pursuing a specific business goal and announces that goal as well as an intended approach for reaching it" if "other approaches to reaching the goal . . . are under active and serious consideration." That proposition is beside the point here, because Lead Plaintiff does not identify any announcement of a "goal" and "an intended approach for reaching it." The only relevance of *Time Warner* in this case is its holding that an issuer's statements about potential transaction negotiations did *not* trigger a further disclosure duty because the statements did not disclose that the "deals would be struck by a certain date, or even that it was likely that deals would be struck at all." *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 262, 267 (2d Cir. 1993). The same conclusion applies *a fortiori* in the present case, where defendants did not make *any* statement about transaction negotiations.

In sum, while Lead Plaintiff spends 15 pages arguing that "a duty to disclose material facts arises when a corporation has made inaccurate, incomplete, or misleading disclosures" (Pl. Mem. at 7-8), it makes no serious effort to identify any "inaccurate, incomplete or misleading disclosure" — and cannot do so. To the contrary, Lead Plaintiff's memorandum is striking for the absence of even a single such "materially false and misleading statement" that Lead Plaintiff deems worthy of identifying and quoting in full. Instead, Lead Plaintiff drops a few out-of-

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misleading," given, among other things, "'rampant customer dissatisfaction' because there were numerous complaints. . . ."; and that "AT & T was scaling back its partnership with Quintel," given the effect that would have on the representation that AT&T's partnership "accounted for significant increases in net revenues.").

context snippets into a couple of small-type footnotes (Pl. Mem. at 11 n. 10), and purports to list the allegedly misleading statements in an 11-page, single-spaced "Exhibit A" tacked onto to its 38-page Memorandum — apparently hoping the Court, on its own, will find something there that it considers misleading. But Lead Plaintiff does not even attempt to answer the specific showings in defendants' opening memorandum, which explained *why* those statements are *not* misleading in any way. (*See* Def. Mem. at 17-21). To cite just four examples:

A. The Bond Portfolio Sale

Defendants' opening memorandum noted that Lead Plaintiff's allegation of a statement that Centerline had achieved "the completion of corporate re-engineering," which Lead Plaintiff claims "served to reassure investors who sought the continuation of Centerline's conservative, predictable, largely tax-exempt revenue" stream "and concealed the agreement . . . to dispose of the tax-exempt bond portfolio" (Cplt. ¶ 72; *see* Def. Mem. at 20), is not actionable. As defendants pointed out, the quoted statement did not mention the tax-exempt bond portfolio, tax-exempt revenue or any "conservative" or "predictable" revenue stream — but referred to the Company's acquisition of a "leading high-yield CMBS fund manager[]," the "launch of . . . a credit risk products company," the "rollout of a new credit approval process," the "divesture of two non-core investments," the "completion of a corporate reengineering" that was aimed at creating "a more efficient operating structure" (Cplt. ¶ 72, quoting March 12, 2007 Centerline press release), and, as Mr. Schnitzer elaborated in a call with analyts the next day, included a "branding initiative" (Cplt. ¶ 82; *see* Pl. Ex. A, at 2.)

Rather than respond, Lead Plaintiff includes a butchered version of the statement at issue in its 11-page Exhibit, excising all of the language from the March 12, 2007 press release quoted immediately above. (*Compare* Cplt. ¶ 72 *with* Pl. Ex. A, at 1.) Lead Plaintiff's need to rewrite this statement is telling, particularly given its own acknowledgment that "the context and meaning of each alleged misrepresentation must be considered, not in isolation, but in light of all the representations made and the surrounding circumstances." (Pl. Mem. at 21, quoting *Riggs*. v. *Termeer*, 2004 WL 540490, at *1 (S.D.N.Y. March 17, 2004).

Lead Plaintiff is similarly silent in response to defendants' showing regarding the one statement cited in the Complaint that even arguably touches on future plans regarding the bond portfolio: a November 8, 2007 statement by Centerline CEO Mark Schnitzer, responding to an analyst who noted that Centerline is "obviously executing along [the] track [of] turning into a fund manager" and asked whether, "related to that, [Centerline had] ever considered . . .taking the bonds off [the Company's] balance sheet or letting them roll off into some other sort of vehicle." (Cplt. ¶ 113.) Mr. Schnitzer responded that "clearly a strategy like that plays into the overall evolution of the Company. So clearly it's something that we've thought about from time to time." (*Id.*) He then went on to explain *why* maintaining the bond portfolio was inconsistent with Centerline's strategy and, in response to a follow-up question, stated:

> We've thought about that and many other options. But, clearly, that's one that would come to mind right away.

(*Id.*)

No one who heard or read this dialogue could plausibly believe that Mr. Schnitzer was "assuring" investors that Centerline "would retain its tax exempt bond portfolio . . . for the foreseeable future" when he said that doing the opposite "clearly . . . plays into the overall evolution of the Company," explained why that was the case, and reiterated that such a transaction "clearly . . . would come to mind right away." (*See* Cplt. ¶ 8, cited in Pl. Ex. A, at 11.)[6]

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[6] In fact, defendants had no way of knowing whether the sale of the bond portfolio would be completed given the contingencies evident in the potential transaction – contingencies implicitly

B. Centerline's Dividend Policy

Nor does Lead Plaintiff respond to defendants' showing that a November 2007 statement that management "would … not recommend a change in dividend policy to our Board" (Cplt. ¶ 113; *see also id.* ¶ 12) was not misleading, because it expressly referred to the *2007* dividend, which was not cut. (Def. Mem. at 21.) Although Lead Plaintiff persists in *asserting* that "[d]efendants specifically rejected suggestions that the [2008] dividend might be reduced" (P. Mem. at 11 n.10), no such statement is identified. Instead, Lead Plaintiff once again plays fast and loose, including its quotation of an August 9, 2007 statement by Mr. Schnitzer that defendants "currently have no intention of suggesting any modification to our dividend" (Pl. Ex. A, at 4, quoting Cplt. ¶ 102), while editing out the question Mr. Schnitzer was addressing:

> You mentioned that the new guidance on your [cash available for distribution] would cover the dividend. And I wonder how confident you were that you would maintain that $1.68 *for the* year . . .[7]

Lead Plaintiff conveniently ignores that, consistent with Mr. Schnitzer's statement, Centerline did in fact pay out a $1.68 dividend for 2007, and did not say anything at all about the 2008 dividend.

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acknowledged by the Complaint itself. (*See* Def. Mem. at 12-13 (citing Cplt.); *see also* Cplt. ¶¶ 49, 56 ("Freddie Mac would not have accepted Centerline's tax-exempt bonds" until "all of the credit enhancements issued by Merrill Lynch and others [were] unwound"); *id.* ¶ 50 ("Centerline had to embark upon the time-consuming process of negotiating" the terms of the "removal of the credit enhancements with the credit enhancers of each tax-exempt bond and tax credit investment which Centerline issued"); *id.* ¶ 53 (because "Centerline had to pay a fee" to the trust investors "to terminate the trusts and release the collateral," the Company had to successfully negotiate a termination fee with investors before it could "proceed with the sale of the tax-exempt bonds to Freddie Mac")).

[7] (Declaration of Umair A. Muhajir, Dec. 19, 2008 ("Muhajir Dec."), Ex. A (excerpts from Aug. 9, 2007 Centerline Holding Company Earnings Conference Call)).

C. Centerline's Need For Capital

Lead Plaintiff does not even claim to identify any statement that was false or misleading for failure to make advance disclosure of the TRCLP Investment. (*See* Pl. Mem. Ex. A.) In two small-type footnotes, however, Lead Plaintiff asserts that defendants misrepresented the existence of a liquidity problem. (P. Mem. at 11 n.10; 16 n.16.) But as shown in defendants' opening memorandum, the allegation that Centerline "was in critical need of capital to fund its growth plans," supposedly "contrary to . . . Class Period representations that there was no liquidity problem," confuses illiquidity with a need for capital. (Def. Mem at 7 n.3.) Lead Plaintiff — once again —– offers no response. In any event, the statements at issue are alleged to have been made four months *before* the Complaint alleges a liquidity problem existed. (Cplt. ¶¶ 100, 125, quoting defendant Levy's August 9, 2007 statement that "we are being very careful to maintain our liquidity in the face of the recent market turbulence"). A need for capital at year-end 2007, in connection with a transformation of the business, and amidst a developing market-wide crisis of confidence, does not support an inference that statements made months *earlier*, in very different circumstances, were untrue. (*See*, *e.g.*, Cplt. ¶ 15 (quoting August 2007 statement that Centerline had "sufficient capital resources to execute [its] 'business plan'"); ¶ 99 (quoting August 2007 statement that Centerline "was not experiencing any liquidity problems").)

Ultimately, Lead Plaintiff's claim boils down to the position that any statement about the current state of any aspect of an issuer's business creates a duty to disclose any change to the business that is "in the works," regardless of how uncertain it is, and despite explicit SEC rules to the contrary. Lead Plaintiff's submission may be searched in vain for any authority supporting that position.

II.

THE COMPLAINT DOES NOT ADEQUATELY PLEAD SCIENTER.

Lead Plaintiff's arguments concerning *scienter* come no closer to addressing defendants' points than its arguments about alleged false or misleading statements. Once again, Lead Plaintiff spends several pages arguing a point that is not in dispute: that defendants knew the sale of the bond portfolio was "in the works" and, if consummated, would be "transformational" for Centerline. But Lead Plaintiff offers no adequate response to defendants' opening memorandum.

First, as previously shown, defendants' undisputed compliance with applicable SEC disclosure requirements eliminates any possible inference — let alone an inference that is "cogent and at least as compelling as any opposing inference one could draw," as required under *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 127 S.Ct. 2499, 2502 (2007) — that defendants' reliance on those rules to guide their behavior (and thus their "failure" to make the affirmative disclosures at issue in this lawsuit) was fraudulent or reckless. Lead Plaintiff spends page after page showing that defendants knew about these potential transactions well before they were disclosed (Pl. Mem. at 23-28), but that begs the question. Defendants have never disputed that they knew about the relevant transactions; the issue is whether the defendants recklessly breached a known disclosure obligation with respect to what they knew. On that issue, Lead Plaintiff does not cite any authority finding *scienter* adequately pled where defendants had complied with SEC disclosure requirements.[8] In essence, Lead Plaintiff assumes the very

[8] Lead Plaintiff correctly notes that *In re Morgan Stanley & Van Kampen Mut. Fund Sec. Litig.*, No. 03 Civ. 8208 (RO), 2006 WL 1008138, at *11 (S.D.N.Y. Apr. 18, 2006), and *Geiger* v. *Solomon-Page Group, Ltd.*, 933 F. Supp. 1180, 1191 (S.D.N.Y. 1996), both involved nondisclosures that the court in each case found not to be material. (Pl. Mem. at 24-25.) But Lead Plaintiff does not and cannot dispute that the court in each case expressly relied on the

conclusion it must support, arguing that this case is distinguishable from those that have relied on compliance with SEC requirements to reject *scienter* allegations, because in this case, defendants' statements were supposedly "designed to and did give investors a false and misleading portrayal of true facts." (Pl. Mem. at 24.) But merely asserting that defendants had wrongful intent is of course inadequate under the PSLRA and *Tellabs.* There is no adequate pleading of *scienter* by knowledge or recklessness "[a]bsent some allegation that defendants knew or were highly unreasonable in not knowing that they were doing something illicit." *In re Canandaigua Sec. Litig.*, 944 F. Supp. 1202, 1214 (S.D.N.Y. 1996).

Second, we previously demonstrated that no fraudulent motive is possible here because *all* of the Individual Defendants own significant quantities of Centerline stock and/or options (with exercise prices well in excess of the post-December 28, 2007 share price), and none is alleged to have sold during the Class Period. (Def. Mem. at 27.) With respect to Messrs. Schnitzer and Levy, Lead Plaintiff's opposition is essentially confined to disputing that such an absence of sales is sufficient to negate any inference of fraudulent motive. (Pl. Mem. at 32.) Lead Plaintiff is wrong on the substance of this point,[9] but even if these facts did not negate any inference of fraudulent motive, it would make no difference, because Lead Plaintiff does not

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defendants' compliance with SEC requirements in rejecting the plaintiff's *scienter* allegations as inadequate.

[9] Lead Plaintiff ignores the fact that the Individual Defendants — as well as other members of senior management — not only did not sell stock during the class period, but were in fact accumulating it. (*Compare* Centerline April 23, 2007 Form DEF 14A at 53-55 (Muhajir Dec., Ex. B.); *with* Centerline April 25, 2008 DEF 14A at 46-48 (Muhajir Dec., Ex. C), (showing that Messrs. Schnitzer, Levy, Ross, and Blau; as well as other members of senior management or the Board, each bought large numbers of shares of Centerline common stock in 2007 and early 2008).) *See Rothman* v. *Gregor*, 220 F.3d 81, 94 (2d Cir. 2000) (insider's purchases of stock and overall increase of stock holdings during the class period show lack of *scienter*); *In re NTL, Inc. Sec. Litig.*, 347 F. Supp. 2d 15, 30 (S.D.N.Y. 2004) (acquisition of shares is contrary to the self-interest of insiders allegedly inflating stock price, and thus negates *scienter*).

explain how it has pled any fraudulent motive that needs to be negated.[10] It is of course Lead Plaintiff's burden to plead *scienter*.

With respect to Messrs. Ross and Blau, the notion that Mr. Ross had an interest in "caus[ing] Centerline's stock price to plummet" so he allegedly could take the Company private at a "bargain basement" price is economic gibberish. (Cplt. ¶¶ 10, 32; Pl. Mem. at 29-30.) Plaintiffs allege that Ross and Blau beneficially own over 10 million shares of Centerline (Cplt. ¶ 32, 33) and that during the Class Period, the share price dropped over $17 a share (Cplt. ¶ 10) – meaning that Ross and Blau *lost* over $170 million. On top of this, they invested $131 million of new money to buy the preferred stock (Cplt. ¶ 9) with a conversion feature exercisable only at $10.75 a share (Cplt. ¶ 18) – which would not in the slightest allow them to "take the company private" (Cplt. ¶ 10) at the far lower post-announcement trading prices ($5 and below, *see* Cplt. ¶¶ 129, 139) that Lead Plaintiff says Ross wanted to engineer: the conversion feature is not exercisable at those prices. In short, Lead Plaintiff's supposed "evidence" of motive is that Ross

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[10] Lead Plaintiff asserts that financial incentives, such as bonuses, "may be combined with other allegations of motive to raise a strong inference of scienter[.]" (Pl. Mem. at 32 n.35). It is black letter law, however, that a plaintiff cannot create a strong inference of *scienter* by simply pleading motives (such as the desire for compensation) that are common to most market participants. (*See* Def. Mem. at 26 n.19.)

Lead Plaintiff also contends in a footnote that it has adequately pled a fraudulent motive on the part of Messrs. Schnitzer and Levy by alleging that they were "beholden" to Mr. Ross, who allegedly had an "interest in taking Centerline private at a 'bargain basement' price." (Pl. Mem. at 32 n.34.) As previously shown, however, those allegations are deficient as a matter of law because (a) the Complaint does not adequately plead that Messrs. Schnitzer and Levy were "beholden to Mr. Ross; and (b) Lead Plaintiff's arguments depend upon his motive allegations as to Mr. Ross, which are themselves deficient. (*See* Def. Mem. at 25-27; *infra* pp. 14-16.) Lead Plaintiff offers no response. In any event, under the PSLRA, *scienter* must be pled individually, on a defendant-by-defendant basis, and Lead Plaintiff cannot claim to have done so. *See In re AOL Time Warner*, *Inc. Sec. and "ERISA" Litig.*, 381 F. Supp. 2d 192, 217 (S.D.N.Y. 2004) (To plead *scienter*, "a complaint must allege facts giving rise to a strong inference of fraudulent intent *for each defendant*.") (Emphasis added).

and Blau gave up over $300 million in value to acquire an economically unexercisable conversion right – a foolhardy proposition so contrary to their self-interest that far from pleading *scienter*, it actually negates it. *See Shields* v. *Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1130 (2d Cir. 1994) ("In looking for a sufficient allegation of motive, we assume that the defendant is acting in his or her informed economic self-interest."); *Hampshire Equity Partners II, L.P.* v. *Teradyne, Inc.*, No. 04 Civ. 3318 (LAP), 2005 WL 736217, at *3 (S.D.N.Y. Mar. 30, 2005) (finding no *scienter* where plaintiffs alleged that defendants were "hedging their bets" by retaining a potential supplier, while also planning to terminate the supplier because "allegations of irrational motive cannot support a fraud claim under Rule 9(b)"); *In re NTL*, 347 F. Supp. at 30.

Furthermore, even if one were to accept the nonsensical economics of the proposition, the allegations establish at most a motive to *complete* the transactions at issue — *not* a motive to withhold or delay the *disclosure*. (Def. Mem. at 25-26.) And Lead Plaintiff's response confirms the point, asserting that defendant Ross "had compelling personal financial incentives *for causing Centerline to sell the tax-exempt bond portfolio*," and that defendants Ross and Blau "were *motivated to engineer* the sweetheart deal to invest $131 million in Centerline in exchange for 11% Convertible Preferred Stock[.]" (Pl. Mem. at 29-30, emphasis added.) Lead Plaintiff's only attempt to tie this motive to alleged concealment consists of a single incoherent sentence at the end of a lengthy, small-type footnote, asserting that Mr. Ross:

> had a compelling personal and financial motivation for concealing the sale of the tax-exempt bond portfolio so that the price of Centerline stock would be driven down by the market's surprise and the flight of Centerline's income-oriented investors upon learning of this startling "transformational transaction."

(Pl. Mem. at 30 n.29.)

Lead Plaintiff does not even attempt to explain why the alleged drop in the stock price, the market's "surprise," and the "flight of Centerline's income-oriented investors" would have been any less severe if the "transformational transaction" had been revealed at any earlier time. Nor does Lead Plaintiff explain how Mr. Ross could have had any motive to delay the expected drop in Centerline's stock price until after he and his company agreed to purchase $131 million of Centerline convertible preferred stock with a conversion price of $10.75, based on the *pre-disclosure* market price for Centerline common stock. *Earlier* disclosure would have produced a lower conversion piece, translating into a benefit of millions of dollars to Mr. Ross. (*See* Def. Mem. at 25-26.) Lead Plaintiff claims that the benefits of the convertible preferred to Messrs. Ross and Blau "far outweighed" the cost of a higher conversion price, but that is entirely beside the point. The benefits referred to do *not* arise from *delaying disclosure*, but — again — from the *transaction itself*. Lead Plaintiff does not explain why Messrs. Ross and Blau would be motivated to achieve those benefits in the manner most costly to them, when they could get the same benefits at a better price (*i.e.*, a lower conversion price) by making earlier disclosure.[11]

[11] Lead Plaintiff contends that "the inference of scienter is not negated by the irrationality of a scheme." (Pl. Mem. at 31.) But the cases cited in that connection provide no help to Lead Plaintiff. In *Robbins* v. *Moore Medical Corp.*, 788 F. Supp. 179 (S.D.N.Y. 1992) (Pl. Mem. at 31), the "irrationality" the Court found unpersuasive was the claim that defendants couldn't have committed fraud because they knew the concealed problems would have to be disclosed soon. *See* 788 F. Supp. at 191 & n.8. Likewise, the defendants in *In re eSpeed, Inc. Securities Litigation*, 457 F. Supp. 2d 266 (S.D.N.Y. 2006), had claimed the alleged motive was irrational because the fraud was risky and "doomed to fail"; the court found that it was not irrational for the insiders to misrepresent the state of the company and thereby indefinitely inflate eSpeed's share price. 457 F. Supp. 2d. at 288-89. *Robbins* and *eSpeed* are a very far cry from this case, where the irrationality does not depend on a claim that the fraud was likely to fail but that it would be costly to the defendants *if it worked*. In fact, this case involves exactly the sort of allegations the court in *eSpeed* said should be dismissed, namely, "where crediting plaintiffs' allegations would mean believing that defendants went out of their way to lose vast sums of money." *Id*.

IV.

THE COMPLAINT DOES NOT ADEQUATELY PLEAD LOSS CAUSATION.

Defendants' opening memorandum established that the Complaint does not adequately plead loss causation because it: (a) does not plead any corrective disclosure to support a finding of loss causation at any time before December 28, 2007; and (b) does not adequately plead facts establishing that the revelation of alleged fraud on December 28, 2007 caused the reduction in stock price. (Def. Mem. 28-34.) Lead Plaintiff does not contest the first point. (*See* Pl. Mem. at 37 & nn.42, 43.) As for the second, Lead Plaintiff's arguments are without merit.

As previously shown, the Complaint fails to plead loss causation with respect to the stock price drop on December 28, 2007, because it does not "distinguish the alleged fraud from the 'tangle of [other] factors' that affect a stock's price" on that date. *In re Merrill Lynch & Co. Research Reports Sec. Litig.*, Nos. 02 MDL 1484, 02 CIV 9690 (JFK), 2008 WL 2324111, at *7 (S.D.N.Y. June 4, 2008) (quoting *Dura Pharm. Inc.* v. *Broudo,* 544 U.S. 336, 343(2005)). In particular, where there is more than one disclosure on a particular day that potentially results in a stock price drop, a plaintiff cannot show loss causation by aggregating the impact of disclosures of actions or events that are *not* alleged to be problematic with those that are alleged to have been improper. (*See* Def. Mem. at 32-33.) Rather than respond to this point, Lead Plaintiff — once again — addresses one that defendants did not raise.

Indeed, it is only by misstating defendants' argument that Lead Plaintiff can muster any response at all. Thus, Lead Plaintiff asserts that defendants "contend that Lead Plaintiff should be required to separate as causal factors the disclosures about the sale to Freddie Mac, the reduction in the dividend, and the deal with TRCLP[.]" (Pl. Mem. at 35-36.) Having thus stated the issue, Lead Plaintiff then argues that it is not necessary at this stage to determine which element of the alleged fraud was responsible for the decline in Centerline's stock price on

December 28, 2007. (*Id*. at 36.) What defendants actually said, however, is that Centerline made *other* announcements on the same day, which are not implicated in the alleged fraud at all, and that it is incumbent upon Lead Plaintiff to plead facts establishing that the stock price drop was actually caused by disclosures relating to the alleged fraud, as opposed to other announcements by the Company. (*See* Def. Mem. at 32-34.)[12] This point, on which Lead Plaintiff is utterly silent, raises a far different issue from the one Lead Plaintiff prefers to address, *i.e.*, allocating loss *among* alleged fraud-related disclosures.[13]

CONCLUSION

For the foregoing reasons and those set forth in Defendants' Memorandum of Law in Support of Their Motion to Dismiss the Consolidated Class Action Complaint, October 27, 2008, the Complaint should be dismissed with prejudice.

Dated: December 19, 2008
New York, New York

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[12] To the extent that *In re Bristol Myers Squibb Co. Securites Litigation*, No. 07 Civ. 5867 (PAC), 2008 WL 3884384 (S.D.N.Y. Aug. 20, 2008) suggests otherwise, we submit that it was wrongly decided and should not be followed.

[13] Additionally, as stated in *Lentell* v. *Merrill Lynch & Co., Inc.*, 396 F.3d 161 (2d Cir. 2005) (Pl. Mem. at 36 & n.41), "'when the plaintiff's loss coincides with a marketwide phenomenon causing comparable losses to other investors, the prospect that the plaintiff's loss was caused by the fraud decreases,' and a plaintiff's claim fails when 'it has not adequately ple[]d facts which, if proven, would show that its loss was caused by the alleged misstatements as opposed to intervening events." *Lentell*, 396 F. 3d at 174 (internal citations omitted). (*See* Def. Mem. at 32-34 (citing cases).) Lead Plaintiff asserts that the Court may not consider the credit crisis that surrounded Centerline's various announcements on December 28, 2007, "to the extent it seeks to rely on evidence outside the Complaint." (Pl. Mem. at 35.) In fact, the market conditions referred to *are* alleged in the Complaint and are discussed in documents that are incorporated into the Complaint. (*See* Cplt. ¶¶ 99-104, 111-12, 125.)

Respectfully submitted,

/s/ Richard A. Rosen

Richard A. Rosen
Daniel J. Leffell
PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP
1285 Avenue of the Americas
New York, NY 10019
Tel: 212-373-3000
Fax: 212-373-2359
rrosen@paulweiss.com

Attorneys for Marc. D. Schnitzer and Robert L. Levy

/s/ Peter L. Simmons

Peter L. Simmons
FRIED, FRANK, HARRIS, SHRIVER & JACOBSON LLP
1 New York Plaza
New York, NY 10022
Tel: 212-859-8455
Fax: 212-859-4000
peter.simmons@friedfrank.com

Attorneys for Defendants Stephen M. Ross and Jeffrey T. Blau

/s/ Jennifer F. Beltrami
Jennifer F. Beltrami
WOLFBLOCK LLP
250 Park Avenue
New York, NY 10177
Tel: 212-883-4955
Fax: 212-672-1155
jbeltrami@wolfblock.com

Attorneys for Centerline Holding Company

Filed on behalf of Marc D. Schnitzer, Robert L. Levy, Stephen M. Ross, Jeffrey T. Blau, and Centerline Holding Company upon consent.