IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

PADDY WOOD, Plaintiff, v. CHARLES C. BAUM, RICHARD O. BERNDT, EDDIE C. BROWN, MICHAEL L. FALCONE, ROBERT S. HILLMAN, MARK K. JOSEPH, BARBARA B. LUCAS, DOUGLAS A. McGREGOR, ARTHUR S. MEHLMAN, FRED N. PRATT, JR. and ROBERT J. BANKS Defendants, and MUNICIPAL MORTGAGE & EQUITY, LLC, Nominal Defendants.	C.A. No. 2404-VCL

DEFENDANTS' OPENING BRIEF IN SUPPORT OF THEIR MOTION TO DISMISS THE AMENDED SHAREHOLDER DERIVATIVE COMPLAINT

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PRELIMINARY STATEMENT

Plaintiff has filed an Amended Shareholder Derivative Complaint ("Complaint")[1] against Municipal Mortgage & Equity, LLC ("MMA" or the "Company") and each of the ten current members of its Board and one former director ("Director Defendants"). Substantial in length but short on substance, the rambling 82-page amended Complaint— like its equally deficient predecessor — fails to plead with particularity sufficient facts to excuse Plaintiff's failure to make a pre-suit demand as required under Delaware law. It should be dismissed with prejudice in its entirety.

MMA is a publicly-traded, limited liability company that, among other things, invests in tax-exempt bonds and other housing-related debt and equity investments. As the Complaint concedes, the Company has provided, and continues to provide, a consistent return on investment for its shareholders since going public in 1996.[2] Against this backdrop of success, Plaintiff stands alone among MMA shareholders in claiming that the Director Defendants failed to adequately oversee MMA's accounting and tax law compliance practices relating to: (a) the declaration of allegedly excessive dividends (that were paid pro rata to all shareholders); (b) the valuation and debt service of certain assets in MMA's bond portfolio; and (c) the "enormous profits" MMA earned for its shareholders in connection with the sale of three of its real estate investments. The Complaint also purports to challenge the incentive compensation paid to

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[1] The Complaint is cited herein in the form "Compl. at ¶ ____."

[2] Compl. at ¶¶ 19, 26, 29.

Defendants Michael Falcone, MMA's President and CEO, and Mark Joseph, MMA's Chairman of the Board.[3]

Plaintiff's critique of the Company's accounting and tax compliance practices is a purely hypothetical one. It speculates that the Company's investors may, someday, be subject to tax liabilities or a possible regulatory investigation of some undisclosed variety. Plaintiff, in short, simply disagrees with the judgment of MMA's accounting and tax compliance experts without being able to demonstrate, through particularized facts or otherwise, that those experts have been proven wrong or that it was unreasonable for the MMA Board to rely on them. Indeed, the challenged accounting and tax compliance practices have caused no cognizable harm to either the Company or its shareholders and, as the Complaint itself admits, the Company's shareholders have benefitted from its successful management and oversight of its many operations.

Even putting aside these infirmities, the Complaint should be dismissed because it does not allege particularized facts sufficient to excuse her failure to make a pre-suit demand. To adequately plead demand futility under the circumstances of this case, Plaintiff must allege with particularity facts sufficient to establish "a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand."[4] The Complaint does not, and cannot, plead any such facts.

Plaintiff alleges no facts ─ *none* ─ that even suggest that a majority of the MMA Board was interested in the transactions at issue or otherwise lacked independence. Taking every

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[3] Compl. at ¶¶ 167, 178.

[4] *Rales v. Blasband,* 634 A.2d 927, 934 (Del. 1993).

allegation in the Complaint as true and giving Plaintiff the benefit of every reasonable inference that could be drawn from the facts alleged, at least seven of MMA's ten current Board members are outside directors who are independent and disinterested. With respect to no fewer than six of the Board's ten current members (who alone constitute a majority), the *only* pertinent facts alleged are that they served on the Board, with some of them serving on the Board's Audit or Compensation Committees.[5]

Confronted with a clearly independent and disinterested Board, Plaintiff resorts to the familiar "incantation" that demand would have been futile because it would have required the Director Defendants to sue themselves. This "bootstrap argument" has "been made to and dismissed by other courts"[6] — most recently in the Delaware Supreme Court decision in *Stone v. Ritter*[7] — and it requires that Plaintiff plead with particularity a *non-exculpated* claim with specific facts that, if proven, would establish that Defendants consciously failed to act in good faith by systematically failing to exercise reasonable oversight. Far from meeting that stringent standard, Plaintiff all but ignores the broad statutory and contractual immunity that "fully protects" the Director Defendants for the types of acts and omissions alleged in the Complaint. And, much of what she pleads confirms, rather than refutes, that the Board has and maintains policies and procedures that establish its good-faith discharge of its oversight responsibilities.

The Complaint, for example, repeatedly refers to a restatement of earnings the Company recently announced (a restatement that has nothing whatsoever to do with *any* of the accounting

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5 Compl. at ¶¶ 4, 6, 8, 10-12.

6 *Aronson v. Lewis*, 473 A.2d 805, 818 (Del. 1984).

7 911 A.2d 362, 367 (Del. 2006).

or other practices or transactions alleged the Complaint).[8] Defying all logic, Plaintiff claims that the Director Defendants' vigilant oversight in connection with the restatement somehow renders them "unable to prosecute claims against themselves if plaintiff demanded that they do so."[9] But rather than establish that demand would be futile, Plaintiff's allegations merely reflect the Board's rigor and candor ─ uncompromised by any vague and unwarranted prospect of personal liability ─ in addressing the accounting and other issues that led to the recent restatement. Falling under the weight of its own allegations, the Complaint cannot credibly assert that these same Director Defendants would not have been impartial in responding to the accounting and other issues alleged here.

In sum, Plaintiff alleges no particularized facts that, if proven, would demonstrate that the Director Defendants were grossly negligent, acted in bad faith, or consciously participated in or authorized any action that was "outside the bounds of reason." Instead, the Complaint itself demonstrates that the Board responsibly discharged its oversight responsibilities, was fully informed about the matters it considered, and made reasonable judgments and decisions with respect to them. The Complaint, therefore, should be dismissed in its entirety.

PROCEDURAL BACKGROUND

Plaintiff filed her original complaint on September 7, 2006. On November 30, 2007, the Defendants moved to dismiss that complaint, establishing that Plaintiff had failed to sufficiently allege demand futility on essentially the same grounds set forth here. On March 7, 2007, in lieu of responding to the merits of the motion to dismiss, Plaintiff filed an amended Complaint

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[8] Compl. at ¶¶ 164-166.

[9] *Id.* at ¶ 84, 147-153.

pursuant to Delaware Chancery Rule 15(aaa). Because the amended Complaint does not cure the fundamental pleading deficiencies of its predecessor, Defendants moved to dismiss it by motions dated March 21, 2007 and April 10, 2007.[10]

STATEMENT OF ALLEGED FACTS

Despite its impressive girth, the amended Complaint adds no new particularized factual allegations sufficient to survive this Motion. The amended Complaint largely intones the same basic allegations of its predecessor, hoping that lengthy repetition and information taken out of context from public filings can substitute for the stringent requirements of pleading demand futility with particularity. Indeed, the amended Complaint is distinguished only by its retreat from some of the outright falsehoods Plaintiff originally pleaded.[11] In their place, Plaintiff conjures up new theories of liability that distort MMA's financial reporting and rely on numerous factual inaccuracies, all of which are nonetheless assumed to be true solely for the purposes of this Motion.

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[10] Plaintiff did not serve either the original complaint or the amended Complaint on Defendant Banks until on or about March 27, 2007 ─ after the other defendants had filed their motion to dismiss on March 21, 2007. Defendant Banks then filed a separate motion to dismiss on April 10, 2007 after he was served. This brief is respectfully submitted in support of both motions to dismiss.

[11] The amended Complaint, for example, no longer alleges the fictional so-called "round trip" transactions fabricated in the original complaint. The original complaint alleged that MMA had taken deeds in lieu of foreclosure on certain properties, sold those properties for a substantial profit, and then repurchased them again from allegedly related entities solely for the purpose of engaging in "illusory transactions" intended to inflate the value of MMA's bond portfolio. In their brief in support of their motion to dismiss the original complaint, Defendants explained that the properties to which the Complaint referred had been sold to unrelated third parties for full value and had not been repurchased as Plaintiff alleged. Confronted with these facts (that a reasonable investigation would have revealed prior to her original filing), Plaintiff now has withdrawn those allegations, offering no explanation as to why they were even pleaded at all.

I. MMA And Its Board Of Directors

Nominal Defendant MMA is a Delaware LLC with its principal place of business in Baltimore, Maryland. As described in the Complaint: "MMA provides debt and equity financing to various parties, invests in tax-exempt bonds and other housing-related debt and equity investments, and is a tax credit syndicator that acquires and transfers low-income housing tax credits."[12] MMA has a ten-member Board of Directors.[13]

Plaintiff alleges the following — *and only the following* — specific facts about Defendants Baum, Brown, Hillman, Lucas, McGregor and Mehlman, who together comprise a majority of MMA's Board:

> 4. Defendant Charles C. Baum has served as a director since 1996. Mr. Baum serves on the Audit Committee of the Board of Directors.
>
> 6. Defendant Eddie C. Brown has been a director of the Company since 2003. Mr. Brown serves on the Audit Committee of the Board of Directors.
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> 8. Robert S. Hillman has been a director of the Company since 1996. Mr. Hillman serves on the Audit Committee of the Board of Directors.
>
> 10. Barbara B. Lucas was named a director of the Company in July, 2005.
>
> 11. Douglas A McGregor has been a director of the Company since 1999.
>
> 12. Arthur S. Mehlman was appointed by the Board of Directors as a director of the Company effective November 1, 2004. Prior to his retirement in 2002, Mr. Mehlman served as a Partner at KPMG, LLP since 1972, in charge of KPMG's audit practice for the Baltimore/Washington region. Mr. Mehlman serves on the Audit Committee of the Board of Directors. The Company represents that Mr. Mehlman meets the Exchange Act definition of an Audit Committee expert.[14]

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[12] Compl. at ¶ 2.

[13] *Id*. at ¶¶ 3-13.

[14] *Id*. at ¶¶ 4, 6, 8, 10-12.

Plaintiff alleges that the seventh outside director, Defendant Fred N. Pratt, Jr., "has been a director of the Company since July 2003" and serves on the Board's Audit Committee. Plaintiff claims that Pratt owns unspecified limited partnership and other interests in unidentified entities "related to [MMA's] affordable housing investment business" but does not explain how or in what way any such interests are related to the acts and omissions alleged in the Complaint.[15]

The only specific allegations in the Complaint with respect to the eighth outside director, Defendant Richard O. Berndt, is that he is the Managing Partner of Gallagher Evelius & Jones LLP ("GEJ"), a law firm which Plaintiff alleges provided $4.9 million in legal services to MMA in 2005.[16]

None of these eight outside directors ─ Baum, Brown, Hillman, Lucas, McGregor, Mehlman, Pratt, and Berndt ─ is alleged to have served as an officer, employee or in any other role (except as a director) at MMA.

Plaintiff also lists former director Robert J. Banks as a defendant but the only facts alleged about Mr. Banks are that he served as a Senior Vice President and Board Member of MMA before his retirement in 2005 and that he was an Executive Vice Chairman of MMA between 2001 and 2003.[17] Defendant Banks was not a director at the time Plaintiff should have made a pre-suit demand on the Board.

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[15] *Id*. at ¶ 13.

[16] *Id.* at ¶ 5.

[17] *Id.* at ¶ 14.

With respect to the two remaining current directors, Defendants Joseph and Falcone, the Complaint asserts that: (a) Falcone serves as Chief Executive Officer and President of MMA and Joseph serves as Chairman of the Board; (b) both directors receive base compensation and performance bonuses payable in cash and/or restricted stock and stock options; (c) both directors had some non-specific ownership interest in properties that allegedly served as collateral on bonds purchased and sold by MMA; (d) both directors own stock in MMA; and (e) Joseph, through some unspecified means, allegedly "controlled" certain entities that were borrowers on bonds that MMA bought and sold.[18]

II. The Accounting And Tax Compliance Practices Alleged In The Complaint

Once sifted and distilled to its essence, the Complaint avers that the Director Defendants breached their fiduciary duties by: (a) allowing MMA to pay all of its shareholders allegedly excessive dividends;[19] (b) failing to oversee whether, and the extent to which, beneficiaries of the Company's charitable contributions were using such funds to service debt held by MMA;[20] (c) failing to properly monitor the financial reporting of certain assets in accordance with an accounting statistic referred to as "other than temporarily impaired;"[21] and (d) failing to oversee the potential tax implications of certain "asset transactions" that earned "enormous profits" for the Company and its shareholders.[22]

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[18] *Id*. at ¶¶ 7, 9.

[19] *Id*. at ¶¶ 26-45.

[20] *Id*. at ¶¶ 46-56.

[21] *Id*. at ¶¶ 57-109.

[22] *Id*. at ¶¶ 110-146.

A. Allegedly Excessive Dividends

Plaintiff first complains that the MMA dividends she and every other shareholder received were *too high* because, she asserts, "from 2000 through 2005, total dividends paid exceeded cash flow from operations as well as net income."[23] In support of this allegation, the Complaint proffers a table that purports to show MMA's cash flow figures for each of those five years.[24] Plaintiff, however, admits in the Complaint that this table alters the financial data actually reported by MMA[25] and further concedes by omission that the manipulated figures do not detail the quarterly data on which the dividends were declared.[26] There is nothing in the Complaint that suggests that the Board failed to rely in good faith on the records of the Company or on qualified persons capable of determining the assets and funds from which dividends might properly be paid. Nor does the Complaint allege that any member of the MMA Board was ever advised that the Company's cash available for distribution did not support its quarterly dividends.

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[23] *Id*. at ¶ 30.

[24] *Id.*

[25] *Id*. at ¶ 30, note 1 (acknowledging that cash flow figures reported in the Plaintiff's table "excludes changes [sic] from assets and liabilities and preferred share dividend distributions").

[26] Instead, the Complaint cleverly aggregates *total* dividends declared over a five-year period and compares them to the *total* five-year cash flow and operating profit figures (that the Plaintiff admittedly adjusted). Even if cash flow and operating profit were the sole measures by which MMA dividends could be declared (which they are not), such five-year *totals* say nothing about whether cash flow or operating profit *each quarter* was sufficient to support dividends. Indeed, even the Plaintiff's doctored figures confirm that in some years the operating profit and cash flow *exceeded* the dividends. *Id*.

B. Charitable Contributions to Service Debt

Plaintiff next alleges that "Defendants caused the Company to make numerous charitable contributions to non-profit borrowers so that they could, in turn, make debt service payments on bonds owed by the non-profit borrowers to the Company."[27] The Complaint itself, however, undermines this assertion, acknowledging as it must, that MMA did not make charitable contributions directly to any borrower.[28] Rather, as stated in the Complaint, MMA made charitable contributions to MMA Affordable Housing Corporation and Muni Mae Foundation, Inc., wholly separate legal entities that make their own decisions about how to distribute the charitable contributions they receive.[29]

Not surprisingly, therefore, the Complaint does not allege with particularity the Board's role, if any, in reviewing and/or approving the distribution or use of any of MMA's charitable contributions. Plaintiff, in fact, does not allege any particularized facts showing that *any* of the charitable contributions made by MMA were actually used by the recipients for payment of debt service. Nor does the Complaint allege any facts that would show that the Board had any reason to believe that MMA's charitable contributions could not be used by the downstream beneficiaries for debt service (even assuming that they were, in fact, so used).

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[27] *Id.* at ¶ 47.

[28] *Id.* at ¶ 51.

[29] *Id.* at ¶¶ 51, 53, 55.

C. "Other Than Temporarily Impaired"

The Complaint alleges that MMA made incorrect statements in its financial reporting by failing to identify some of the assets in its bond portfolio as "other-than-temporarily impaired."[30] Although the Complaint rambles for nearly 25 pages about this alleged "Treatment of the Company's Non-Performing Assets,"[31] its core contention is that, because certain assets in MMA's bond portfolio had been in default for a sustained period of time, they should not have been identified as only "temporarily impaired" under the definitions set forth in the amended Statement of Financial Accounting Standards (FAS) No. 115.[32]

Plaintiff admits, however, that FAS 115, by its very terms, is subjective and requires a company to make a judgment call about whether "it is probable that the investor will be unable to collect all amounts due."[33] The Complaint also concedes that MMA applied and considered this standard in its financial accounting and concluded that FAS 115 "had no material effect on [MMA's] reported financial condition or results of operations."[34] The Complaint further confirms that MMA explained its rationale for reaching this conclusion, observing that:

> [The Company] performed reviews of the properties collateralizing each bond and concluded that it was probable that [MMA] will receive all amounts due. Because we have the ability and intent to hold these bonds or interests in bond securitizations until the expected recovery of fair value, which may be at maturity,

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30 *Id*. at ¶¶ 57-108.

31 *Id*. at pp. 24-48.

32 *Id*.

33 *Id*. at ¶ 65.

34 *Id*. at ¶¶ 103-104.

> [MMA does] not consider the bonds or interests in bond securitizations to be other-than-temporarily impaired at March 31, 2006.[35]

The Complaint offers no particularized facts that contradict this conclusion. The Complaint, for example, contains no allegations about whether MMA failed to "receive all amounts due" under any bond that Plaintiff claims was not properly designated as "other than temporarily impaired." Nor does the Complaint offer any facts that contradict MMA's good-faith belief that it "has the ability and intent" to hold such assets "until the expected recovery of fair value, which may be at maturity."[36] And it fails to allege any specific facts showing that the Board consciously acted in bad faith in relying on management's judgment about how to properly interpret and apply the technical accounting principles reflected in FAS 115. These omissions are not surprising because MMA properly accounted for these assets and has a history of recovering full value on those investments, consistent with management's accounting judgment under FAS 115. The Complaint does not assert otherwise.

D. "Improper Asset Transactions"

The Complaint also challenges the Board's oversight of the potential tax compliance implications of what Plaintiff characterizes as "improper asset transactions." Specifically, the Complaint asserts that, with respect to three of its hundreds of holdings, MMA engaged in "related party transactions [that] involved transfers of the securitized property via deeds in lieu of foreclosures from affiliated companies followed by near simultaneous resales of the same property at enormous profits."[37]

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[35] *Id*. at ¶ 104.

[36] *Id*.

[37] *Id*. at ¶¶ 110-146.

The nub of this assertion appears to be that the Director Defendants should somehow be liable to MMA shareholders because the Company earned "enormous profits" on the appreciated value of properties it incurred the risk of financing ─ i.e., for engaging in the very business that the Company was formed to pursue. Plaintiff speculates that this successful business could expose the Company and its shareholders to potential tax liabilities because the transactions allowed the Company to extract value for itself that the prior owners of the properties should have been able to secure.[38]

Although the Complaint asserts that the MMA Board "reviewed, authorized and affirmed" these transactions, it does not set forth any particularized facts that establish that, in doing so, the Board was not fully informed or acting in good faith in the discharge of its oversight responsibilities.[39] The Complaint, for example, does not set forth any specific facts concerning the procedures and processes through which the MMA Board was allegedly deficient in conducting its alleged review and consideration of these transactions. Most importantly, though, the Complaint does not identify any reasons why the Board did not or could not reasonably rely on MMA's tax experts to address any of the tax compliance issues to which Plaintiff alludes in her Complaint.

E. Director Compensation

Plaintiff also alleges that the Defendant Directors breached their fiduciary duties and committed corporate waste by unjustly enriching Defendants Falcone and Joseph with incentive-

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[38] *Id.* at ¶ 133 (alleging that "in the standard lender-borrower relationship, the borrower would simply sell the asset, pay off the debt and retain the net gain for itself.")

[39] *Id*. at ¶ 150.

based bonuses.[40] Plaintiff asserts that Falcone and Joseph earned these performance bonuses "as a result of the improper actions alleged herein."[41] Plaintiff does not allege, however, any facts that would explain how the performance bonuses related to the allegedly improper actions. Nor does Plaintiff allege any facts that would demonstrate that the performance-based compensation was more than the customary compensation senior executives receive at other publicly traded companies operating at a similar size or in the same industry. The Complaint also fails to identify any of the circumstances under which the compensation for Falcone and Joseph was considered and approved.

III. Plaintiff's Demand Futility Allegations

Plaintiff alleges that the required pre-suit demand for these claims is excused because: (a) the Director Defendants "are . . . personally liable to the Company" because they "developed, implemented and approved the policies giving rise to the conduct complained of herein and directly reviewed and authorized the transactions discussed herein;"[42] and (b) the alleged activities "are not subject to the protection of the business judgment rule and could not be ratified, approved, or condoned by disinterested and informed directors under any circumstances."[43] In addition, Plaintiff alleges in conclusory and generic terms that the Director

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[40] *Id*. at ¶¶ 113, 132.

[41] *Id*. at ¶¶ 172, 178.

[42] *Id.* at ¶ 156.

[43] *Id*. at ¶ 162.

Defendants "received their own stock options as compensation, thereby personally benefiting from improper conduct alleged herein."[44]

Plaintiff also alleges that demand should be excused because a number of the directors serve on the Company's Audit Committee that recently concluded that there are some aspects of MMA's financial reporting that need to be re-examined.[45] Plaintiff asserts that the Audit Committee, in fulfilling its function, reported that "management has identified material weaknesses related to the financial reporting process, including the sufficiency of resources dedicated to the Company's accounting function."[46]

Plaintiff, however, offers no specific facts indicating that the Audit Committee's findings are in any way related to the accounting and tax law compliance practices alleged in the Complaint; nor are there any allegations that explain why the Board's willingness to examine ─ through its Audit Committee ─ MMA's financial reporting activities would render it futile for this Plaintiff to ask for such a review with respect to the accounting and other issues described in the Complaint. Instead, the Complaint makes the nonsensical contention that because the Audit Committee demonstrated its independence and vigilance in reporting some unrelated concerns about "the integrity of the financial statements of MMA," those same Audit Committee members are unable to impartially consider the accounting and other issues Plaintiff alleges.[47]

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[44] *Id*. at ¶ 169.

[45] *Id.* at ¶ 165.

[46] *Id*. at ¶ 166.

[47] *Id*. at ¶ 166.

ARGUMENT

Nothing in the Complaint is sufficient to show, as it must, that the Board systematically and consciously in bad faith failed to exercise reasonable oversight. Nor does the Complaint allege particularized facts sufficient to show that the Board committed any non-exculpated act, was grossly negligent or recklessly indifferent to MMA's shareholders, or undertook any actions wholly "without the bounds of reason." Demand, therefore, cannot be excused and this Court should dismiss Plaintiff's Complaint with prejudice for failure to adequately plead demand futility under Court of Chancery Rule 23.1.

I. Delaware Law Requires Plaintiff To First Demand That The Defendant Directors Take The Remedial Action Requested, Or Else Satisfy The Heavy Burden Of Pleading With Factual Particularity That Demand Is Futile

Delaware law requires that "a plaintiff shareholder make a demand upon the [company's] current board to pursue derivative claims owned by the [company] before a shareholder is permitted to pursue legal action on the [company's] behalf."[48] "[T]he demand requirement is a recognition of the fundamental precept that directors manage the business and affairs of corporations,"[49] and it provides a company "the opportunity to address an alleged wrong without litigation, to decide whether to invest the resources of the [company] in litigation, and to control any litigation which does occur."[50] For these reasons, the requirement of a pre-suit demand is a "bedrock principle" of Delaware law.[51]

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[48] *Jacobs v. Yang*, Civ. A. No. 206-N (SPL), 2004 WL 1728521, at *2 (Del. Ch. Aug. 2, 2004); *see* Del. Ch. Ct. R. 23.1.

[49] *Aronson*, 473 A.2d at 812.

[50] *Spiegel v. Buntrock*, 571 A.2d 767, 773 (1990) (citations omitted); *Rattner v. Bidzos*, No. Civ. A. 19700 (JWN), 2003 WL 22284323, at *7 (Del. Ch. Oct. 7, 2003) ("The hurdle of proving demand futility also serves an important policy function of promoting internal (continued…)

Plaintiff failed to make a demand of the MMA Board but claims that such a demand would have been futile.[52] Sufficiently pleading demand futility is a "heavy burden" under Delaware law[53] and "must comply with stringent requirements of factual particularity that differ substantially from the permissive notice pleadings governed solely by Chancery Rule 8(a)."[54] And where demand futility is based on the notion that directors may be personally liable for the alleged conduct, the basis for asserting such liability must also be alleged with factual particularity: "Since a plaintiff must plead with particularity the reasons why demand should be excused, when a reason is that the directors are disabled by the risk of liability, the claim for relief against the directors must also be pled with particularity."[55] Moreover, where the directors are insulated from liability for certain conduct (for example, under statutory or contractual exculpatory provisions), "then a serious threat of liability may only be found to exist if the plaintiff pleads a *non-exculpated* claim against the directors based on particularized facts."[56]

The Delaware Supreme Court has articulated two tests for determining the sufficiency of demand futility allegations. The Supreme Court explained the "traditional" rule in *Aronson*,

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(continued…)

resolution, as opposed to litigation, of corporate disputes and grants the corporation a degree of control over any litigation brought for its benefit") (citations omitted).

[51] *Levine v. Smith*, 591 A.2d 194, 200 (Del. 1991), *overruled on other grounds*, *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

[52] Compl. at ¶ 160.

[53] *Levine*, 591 A.2d at 211.

[54] *Brehm v. Eisner*, 746 A.2d at 254.

[55] *In re Baxter Int'l, Inc. S'holders Litig.*, 654 A.2d 1268, 1270 (Del. Ch. 1995).

[56] *Guttman v. Huang*, 823 A.2d 492, 501 (Del. Ch. 2003).

which applies when the directors are alleged to have made a decision approving a transaction that the plaintiff alleges is a breach of the directors' fiduciary duties:

> Our view is that in determining demand futility the Court of Chancery in the proper exercise of its discretion must decide whether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.[57]

A similar and closely-related test is applied where, as here, the allegations of the Complaint assert a "*Caremark*" claim that the directors "violated a duty to be active monitors of corporate performance" by failing to act when they otherwise should have.[58] Where "the subject of the derivative suit is not a business decision of the board," then the court should apply the test set forth in *Rales,* which requires a court to "determine whether or not the particularized factual allegations of a derivative stockholder complaint create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand."[59]

The Chancery Court's decision in *Guttman* is particularly instructive in how it applied these demand futility tests in circumstances strikingly similar to those alleged here.[60] The plaintiff in that case alleged that the defendant directors "engaged in a variety of misconduct related to [the company's] failure to accurately account for and disclose its financial results" and

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[57] *Aronson*, 473 A.2d at 814.

[58] *Stone*, 911 A.2d at 368, *quoting In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996).

[59] *Rales*, 634 A.2d. at 934.

[60] 823 A.2d 492.

made statements that were "materially misleading because they were premised on improper accounting."[61] The complaint in *Guttman* set forth in detail the alleged accounting irregularities and claimed that the director defendants knew that the company's "improper accounting practices were propping up its stock price artificially and they thus reaped unfair profits by selling [their stock] to buyers who were in the dark about the reality of [the company's] (impliedly more troubled) financial status."[62]

Applying the principles established in both *Rales* and *Aronson*, the Court dismissed the complaint for failure to plead demand futility with particularity. The Court first rejected the plaintiffs' assertion that each of the seven members of the company's board was "interested" or lacked independence, noting the absence of any allegations sufficient to establish that five of the seven board members were "materially dependent" or "beholden" to either of the two other, allegedly conflicted directors.[63] The Court then examined whether the impartiality of the five disinterested and independent directors was "compromised by the threat of personal liability."[64] Reasoning that the complaint did not sufficiently set forth with particularity the predicates for personal director liability arising from the alleged failure to monitor the accounting irregularities, the Court concluded that the "complaint fails to plead facts suggesting that a majority of the

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61 *Id*. at 494.

62 *Id.* at 496.

63 *Id.* at 503.

64 *Id.* at 503-07.

[company's] board faces a sufficient threat of liability to compromise their ability to act impartially on a demand."[65]

The Delaware Supreme Court also recently addressed the circumstances under which demand should be excused where, as here, it is alleged that the defendant directors "face a substantial likelihood of liability" that renders them "personally interested in the outcome of the decision on whether to pursue the claims asserted in the complaint."[66] The plaintiff in *Stone* claimed that the defendant directors "utterly failed to implement any sort of statutorily required monitoring, reporting or information controls that would have enabled them to learn of problems requiring their attention."[67] This alleged oversight failure, the plaintiffs claimed, resulted in the corporation paying $50 million in civil penalties and fines arising from the failure of employees to file "Suspicious Activity Reports" as required by the federal Bank Secrecy Act.[68]

The Delaware Supreme Court affirmed the dismissal of the complaint for failure to plead demand futility. The Court explained that there were no particularized factual allegations sufficient to establish that the directors could be personally liable because "only a sustained or systematic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exists – will establish the lack of good faith that is a necessary condition to liability."[69] "Such a test of liability – lack of good faith as evidenced by

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[65] *Id*. at 507.

[66] *Stone*, 911 A.2d at 367.

[67] *Id*. at 364.

[68] *Id*. at 365-366.

[69] *Id.* at 369, *quoting Caremark*, 698 A.2d at 971.

sustained or systematic failure of a director to exercise reasonable oversight – is quite high," but such "a demanding test of liability in the oversight context is probably beneficial to corporate shareholders as a class, . . . since it makes board service by qualified persons more likely."[70]

Here, as well, whether viewed under either the *Aronson* or *Rales* tests, Plaintiff fails to meet the demand futility pleading requirements.

II. Demand Was Not Futile Because The MMA Board Is Independent And Disinterested

A. The MMA Board Is Independent

Plaintiff fails to allege sufficiently particularized facts that, if true, would support the allegation that a majority of the Board lacked independence. A director lacks "independence" if he or she makes decisions because of extraneous considerations or influences rather than on the corporate merits of the transaction.[71] The *only* facts Plaintiff specifically alleges about six of the Board's eight outside directors ─ Defendants Baum, Brown, Hillman, Lucas, McGregor and Mehlman (who alone represent a majority of the MMA Board) ─ are that each served on the MMA Board and some also served on the Board's Audit Committee.[72] Plaintiff makes no other particularized factual assertion whatsoever with respect to these directors, much less any facts that, if true, would establish a lack of independence.

The independence of these six Director Defendants is, alone, sufficient to conclude that the MMA was independent for purposes of responding to a pre-suit demand. Although not necessary to such a finding, Plaintiff's allegations about the two other outside directors ─

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[70] *Id.*

[71] *Aronson*, 473 A.2d at 816.

[72] Compl. at ¶¶ 4, 6, 8, 10-12.

Defendants Pratt and Berndt ─ also are deficient. With respect to Pratt, the Complaint does little more than allege that he was a member of the Board's Audit Committee and was previously employed by a company that sold one of its divisions to MMA in an unrelated transaction in 2003.[73] With respect to the eighth outside director, Defendant Berndt, the Complaint merely alleges that he is the managing partner of a law firm that was retained and paid several million dollars by MMA for legal services. It does not allege any specific facts about the nature of those services, who performed them or whether they have anything at all to do with anything alleged in the Complaint.[74] Plaintiff's immaterial allegations about Defendant Banks, a former director, are not at all relevant to the question of demand futility, since he was not on the Board at the time the Complaint was filed and a pre-suit demand should have been made.

Plaintiff, therefore, has failed to allege any facts sufficient to excuse demand on the basis of a lack of director independence.[75]

B. The MMA Board Is Disinterested

Plaintiff also fails to plead with particularity that a majority of the MMA Board was interested in the challenged actions. A director is interested if he or she receives "a personal

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[73] *Id*. at ¶ 13.

[74] *Id*. at ¶ 5.

[75] The Complaint makes the half-hearted and vague assertion that "members of the Board acted under dominance of the individuals who primarily benefited from the transactions ratified by the Board." *Id*. at ¶¶ 163, 169. Delaware law is clear that a plaintiff asserting domination and control of one or more directors must allege particularized facts manifesting 'a direction of corporate conduct in such a way as to comport with the wishes or interests of the corporation (or persons) doing the controlling.'" *Aronson,* 473 A.2d at 816 (citation omitted.) Here, Plaintiff alleges no such facts to support her passing references to "domination and control."

financial benefit from a transaction that is not equally shared by the stockholders."[76] With respect to no fewer than six of the Board's ten current members ─ Defendants Baum, Brown, Hillman, Lucas, McGregor and Mehlman ─ the most that can be gleaned from the Complaint is they "received their own stock options as compensation, thereby personally benefiting from improper conduct alleged herein."[77] This conclusory assertion, however, is not supported by any well-pleaded facts that establish any connection whatsoever between the alleged director stock options and the transactions that Plaintiff describes in her Complaint. She does not, for example, allege any facts about whether any outside director actually exercised any such options or sold any MMA stock under circumstances that even remotely would suggest a connection to the alleged transactions.

In addition, Delaware courts commend, not condemn (as Plaintiff would have it) stock compensation to otherwise disinterested and independent directors because it further aligns director interests with that of other shareholders.[78] Indeed, if stock option compensation alone were sufficient to establish a disqualifying interest in any matter considered by a Board, then few, if any, board decisions would be entitled to the business judgment rule presumption and many board members would be disabled from effectively overseeing their companies' affairs.

In *Guttman*, the Court considered a similar contention about director self-interest and rejected it as an improper "attempt to extend concepts designed to fit classic self-dealing

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[76] *Rales*, 634 A.2d at 936; *see Aronson*, 473 A.2d at 812.

[77] Compl. at ¶ 169.

[78] *Cf. McGowan v. Ferro*, 859 A.2d 1012, 1030 (Del. Ch. 2004) ("Delaware law is clear that substantial stockholdings in a company by directors creates powerful incentives to get the best deal in the sale of that company") (citations omitted); *Orman v. Cullman*, 794 A.2d 5, 27 n.56 (Del. Ch. 2002) (same).

transactions into another context that is quite different."[79] The plaintiffs in *Guttman* claimed that each of the board's seven members was "interested" for purposes of considering a demand because they each allegedly benefited from trading in the company's stock at a time when they knew, or should have known, that the company's financial disclosures were misleading and artificially inflated the company's stock price.[80] In rejecting this assertion, the Court considered it "unwise to formulate a common law rule that makes a director 'interested' whenever a derivative plaintiff cursorily alleges that [the director] made sales of company stock in the market at a time when he possessed material, non-public information."[81] Instead, the Court explained, any finding of "interest" sufficient to excuse demand based on alleged interests in company stock must be based on particularized factual allegations that go beyond the "wholly conclusory" allegation that the directors benefited by the purported affect of alleged accounting irregularities on the value of their stock.[82]

Here, Plaintiff does not plead that any stock sales occurred, let alone sales based on inside information about alleged accounting irregularities. Nor does the Complaint explain how, when or under what circumstances any particular director had notice or knowledge that the alleged accounting practices were improper or had any material impact on the Company's financial disclosures. Moreover, Plaintiff does not allege that any of the outside directors'

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[79] 823 A.2d at 502.

[80] *Id.* at 494, 502.

[81] *Id.* at 502.

[82] *Id.* at 503-04.

personal interests in their stock options established in any way a financial interest in the challenged transactions that was in any way different from all other MMA shareholders.

Plaintiff, therefore, has failed to allege any facts sufficient to excuse demand on the basis of director self-interest.[83]

III. Demand Was Not Futile Because The Independent And Disinterested Board Does Not Confront A Serious Threat Of Personal Liability

Because the MMA Board is independent and disinterested, Plaintiff alleges that a pre-suit demand would have been futile nonetheless because the Director Defendants are "personally liable" and, therefore, "cannot be expected to prosecute claims against themselves if plaintiff demanded that they do so."[84] Here, however, no such threat of personal liability exists and Plaintiff does not, and cannot, plead with particularity any facts sufficient to establish otherwise.

A. Demand Was Not Futile Because The Director Defendants Are Exculpated And Indemnified Against The Liability Alleged In The Complaint.

The Delaware Supreme Court recently confirmed that critical to a "personal liability" demand-excused argument is whether the directors are indemnified against, or otherwise exculpated from, any alleged liability.[85] This is because a director who is exculpated from or indemnified against potential liability can impartially respond to a demand without being compromised by a "serious threat" of liability.

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[83] Plaintiff also does not allege, as she must in order to defeat this Motion, that the stock options represented anything other than ordinary and customary compensation that is granted to directors in return for the board services they perform. Nor does Plaintiff allege that the compensation these outside directors received was "material" to their respective interests. *Orman*, 794 A.2d at 23.

[84] Compl. at ¶¶ 160, 164.

[85] *Stone*, 911 A.2d at 367.

Here, the Director Defendants are expressly immunized under MMA's Amended and Restated Certificate of Formation and Operating Agreement ("Operating Agreement")[86] as well as the Delaware Limited Liability Company Act (""LLCA"). The MMA Operating Agreement, in relevant part, provides that:

> No director or officer of the Company shall be liable, responsible, or accountable in damages or otherwise to the Company or any Shareholders ***for any act or omission performed or omitted by him or her, or for any decision, except in the case of fraudulent or illegal conduct of such person.*** For the purposes of this Section 8.1, the fact that an action, omission to act or decision is taken on the advice of counsel for the Company shall be evidence of good faith and lack of fraudulent conduct.[87]

This exculpation and its corollary indemnification provision is pursuant to the "broad statutory authority" established under § 18-1101 of the LLCA which expressly states that a limited liability company agreement "may provide for the ***limitation or elimination of any and all liabilities***…for breach of duties (including fiduciary duties) of a [director]."[88] The permissible scope of any such exculpation, therefore, is substantially broader than that allowed for corporations under the 102(b)(7) exculpation.[89] Indeed, the only limitation the LLCA imposes on a limited liability company's ability to exculpate its directors is a contractual one: it

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[86] *Amended And Restated Certificate of Formation and Operating Agreement of Municipal Mortgage and Equity, L.L.C.*, Article 8.1 (dated May 9, 2002). A true and correct copy of this Operating Agreement, which is expressly incorporated by reference in ¶¶ 56 and 116 of the Complaint, is attached to this Brief as Exhibit A.

[87] *Id*. at § 8.1(a) (emphasis added). The corollary indemnification provisions are set out in § 8.1(b) of the Operating Agreement.

[88] LLCA, § 18-1101(e) (emphasis added).

[89] *Morgan v. Grace*, Civ. A. No. 20430 (SPL), 2003 WL 22461916, at *2 (Del. Ch. Oct. 29, 2003).

"may not limit or eliminate a bad faith violation of the implied *contractual* covenant of good faith and fair dealing."[90]

The LLCA also provides an additional, separate immunity that "fully protects" directors who make decisions in reasonable reliance on the expertise of others. The statute provides that directors:

> …***shall be fully protected*** in relying in good faith upon…information, opinions reports or statements presented by another manager, member, …officer or employee of the limited liability company, …or by any other person as to matters the [director] reasonably believes are within such other person's professional or expert competence, ***including information, opinions, reports or statements as to the value and amount of assets, liabilities, profits or losses of the limited liability company . . . or any other facts pertinent to the existence and amount of assets from which distributions to members or creditors might properly be paid.***[91]

Thus, to meet her pleading burden with respect to her personal liability demand-excused argument, Plaintiff must allege particularized facts sufficient to show that a majority of the Director Defendants who currently sit on the MMA Board: (a) engaged in "fraudulent or illegal conduct"; (b) did not in good faith rely on information provided by the Company's accountants or tax experts; and/or (c) violated in "bad faith" the "implied contractual covenant of good faith and fair dealing." The Complaint does not, and cannot, allege any such non-exculpated claims.

First, the Complaint falls far short of alleging with particularity that any of the individual Director Defendants knowingly engaged in conduct that was "fraudulent or illegal." Indeed, the Complaint does not even purport to state a cause of action for fraud, much less detail the facts necessary to support such a claim. Instead, Plaintiff only vaguely alleges in numerous places

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[90] LLCA, §18-1101(e) (emphasis added).

[91] LLCA, § 18-406 (emphasis added).

that the Director Defendants made "affirmative misrepresentations and omitt[ed] material information vis-a-vis shareholders" and have "actively condoned and facilitated a campaign of deceit."[92] Such conclusory and vague assertions plainly do not suffice to state a claim for fraud under Delaware law. [93]

There are, for example, no particularized factual allegations which, if proven, would support a reasonable inference that *any* of the Director Defendants, let alone a majority of them, made a false representation with the knowledge or belief that it was false. The law is clear that simply stating that the Director Defendants "knew" or "should have known" is not enough to state a claim for fraud with particularity.[94] And merely alleging, as the Plaintiff does here, that the Director Defendants "authorized" the allegedly misleading statements is insufficient because "it does not adequately allege that each of them had knowledge of the misleading nature of those statements."[95] Moreover, the Complaint does not identify what it is the Plaintiff did in purported reliance of the statements she claims were false or misleading; nor does it plead which statements or omissions supposedly caused such reliance.[96]

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92 *See, e.g.*, Compl. at ¶¶ 103, 169.

93 Fraud requires a false representation; made with the knowledge or belief that it was false or with reckless indifference to the truth; an intent to induce the plaintiff to act or to refrain from acting; the plaintiff's action or inaction taken in justifiable reliance upon the representation; and damage to the plaintiff as a result of such reliance. *See, e.g., Metro Communication Corp. BVI v. Advanced Mobilecomm Technologies, Inc*., 854 A.2d. 121, 144 (Del. Ch. 2004).

94 *Id.*, *quoting Twin Coach Co. v. Chance Vought Aircraft, Inc*., 163 A.2d 278, 284 (Del. Super. 1960).

95 *Id*. at 145.

96 *Id*. at 157.

Similarly, although the Complaint in numerous places makes conclusory assertions about alleged violations of securities and tax laws, it does not state with particularity the specific conduct the individual Director Defendants engaged in that was "fraudulent or illegal." Here, as in *Rattner*, the Complaint "is quick to prattle off numerous alleged infractions of laws, rules and principles," but never notes "the Board's involvement in [the Company's] financial recording and reporting systems." As the Supreme Court noted in *Stone*, even proof that a violation of law occurred is not enough to implicate the directors and impose on them personal liability.[97]

What is lacking here are particularized allegations about what specific role each Director Defendant allegedly had in negotiating, consummating or approving the alleged transactions or in making the determination about how to report the value of certain assets in the Company's portfolio. Rather than allege such particulars, the Complaint only summarily alleges that the "Director Defendants have directly ratified the egregious actions complained of herein" and "are named as Defendants herein as a result of their active participation and acquiescence in the scheme."[98] Such cursory allegations are plainly insufficient to plead around the exculpatory and indemnity provisions of the MMA Operating Agreement.[99]

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[97] *Stone*, 911 A.2d at 372 ("The lacuna in plaintiffs' argument is a failure to recognize that the directors' good faith exercise of oversight responsibility may not invariably prevent employees from violating criminal laws, or from causing the corporation to incur significant financial liability.") Notably, in *Stone*, the fact that a violation of law had in fact occurred was not in dispute. Even the existence of an admitted violation of law, however, was insufficient to conclude that the directors had committed it or could be held liable because of it. Here, the premise for director liability is even more specious because no violations of law have occurred and none is adequately pleaded.

[98] Compl. at ¶¶ 160, 164.

[99] Plaintiff also suggests that the Director Defendants "concealed" information as reflected in an alleged "decline in accounting transparency." Compl. ¶¶ 76-85. The Complaint, however, does not contend that the Company has failed to maintain sufficient books and (continued…)

Second, the Complaint does not allege any facts sufficient to circumvent the LLCA immunity that "fully protect" the Director Defendants against personal liability when they reasonably rely on experts employed by the Company.[100] The Complaint, in this regard, acknowledges that, during the entire relevant time period, PricewaterhouseCoopers served as MMA's outside accountant.[101] Yet, the Complaint alleges no particularized facts that would indicate why it was unreasonable for a majority of the Director Defendants to rely on those accountants when the Board was, for example, making decisions about whether to issue dividends or accept the accountant's valuations of assets in the Company's portfolio. Nor does the Complaint set out any particularized facts about whether it was unreasonable for the Board to rely on the Company's tax experts when reviewing or considering charitable contributions or the realization of gains on properties formerly owned by allegedly related non-profit entities. Absent any such allegations, the Complaint fails to state any claim for liability against which the Director Defendants are not "fully protected" under the LLCA.

Third, the Complaint does not purport to allege a "bad faith violation of the implied contractual covenant of good faith and fair dealing." Under Delaware law, the implied covenant of good faith and fair dealing functions to protect "stockholders' expectations that the company and the board will properly perform the contractual obligations" they have under the operative

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(continued…)

records as required under its by-laws and the LLCA. Plaintiff, in fact, has never even made a books and records request for any of the accounting information she claims should have been included in the Company's public filings. *See* LLCA § 18-305 (providing shareholder certain rights to obtain "information regarding the status of the business and financial condition of [a] limited liability company").

[100] LLCA, § 18-406.

[101] Compl. at ¶ 153.

organizational agreements.[102] It serves as "promise of faithfulness to an agreed common purpose and consistency with the justified expectations of the other party."[103]

Delaware courts recognize that the implied covenant of good faith and fair dealing is a creature of contract, distinct from the fiduciary duties that are the subject of the claims that Plaintiff asserts here.[104] And, as this Court recently noted, where a complaint seeks relief for breach of an implied covenant of good faith and fair dealing that overlaps with alleged breaches of fiduciary duties, then the fiduciary duty claims should be dismissed in order to preserve "the primacy of contract law over fiduciary law in matters involving essentially the contractual rights and obligations."[105]

Here, the Complaint does not allege any contractual claims at all, let alone a "bad faith" breach of an implied contractual covenant. The Complaint, in fact, studiously ignores all of the provisions in the MMA Operating Agreement that detail the Board's discretion, authority, and obligations with respect to nearly all of the matters about which Plaintiff complains. The Complaint, for example, ignores the provisions of the Operating Agreement that authorize the Company to (a) issue dividends;[106] (b) issue additional debt and equity;[107] (c) compensate

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[102] *Gale v. Bershad*, Civ. A 15714, 1998 WL 118022 *1-2 (Del. Ch. Mar 4, 1998).

[103] *Pales v. Delaware State Lottery Office,* Civ. A. 1546-N, 2006 WL 1875915, at *5 (Del. Ch. June 29, 2006).

[104] *Blue Chip Capital Fund II Ltd. Partnership v. Tubergen*, 906 A.2d 827, 833 (Del. Ch. 2006).

[105] *Id., quoting Gale v. Bershad*, 1998 WL 118022, at *5 (Del. Ch. Mar. 3, 1998).

[106] Exhibit A, § 5.1.

[107] *Id.* at §§ 2.7 and 3.1.

employees and establish stock option plans;[108] and (d) delegate responsibilities for tax compliance issues.[109] Having ignored all of these and other contractual provisions, Plaintiff could not now plausibly claim to engraft upon any of them an implied covenant of good faith and fair dealing to assert a contractual claim that those provisions have been breached.[110]

Having failed to plead with particularity a non-exculpated claim, Plaintiff cannot meet her burden of demonstrating that the individual Director Defendants face a "substantial risk of liability" that renders futile any demand.[111]

B. Demand Was Not Futile Because The Complaint Itself Confirms That The Board Maintained Reporting And Information Systems and Controls

Even apart from the statutory or contractual exculpatory provisions noted above, the Complaint should be dismissed because the Director Defendants do not confront any risk of personal liability under the well-established standards for oversight claims.[112] Where, as here, a plaintiff is relying on the threat of personal liability to excuse demand in a *Caremark* oversight

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[108] *Id.* at § 2.7.

[109] *Id.* at §§ 3.5 and 4.5.

[110] *See, e.g.*, *Superior Vision Serv., Inc. v. Reliastar Life Ins. Co.*, Civ. A. 1668-N, 2006 WL 252426, (Del. Ch. 2006)(dismissing a claim for breach of an implied covenant of good faith and fair dealing relating to a dispute over dividends governed by a certificate of incorporation); *see also*, *Frontier Oil Corp. v. Holly Corp.*, Civ. A. 20502, 2005 WL 1039027, at *28 (Del. Ch. April 29, 2005)("imposing an obligation on a contracting party through the covenant of good faith and fair dealing is a cautious enterprise and instances [in which it is imposed] should be rare.").

[111] Compl. at ¶ 164.

[112] In many respects, the high threshold of pleading demand futility under Delaware's fiduciary duty common law reflects the similarly high bar set by the statutory and contractual exculpatory analysis set forth above. In all events, the Delaware Supreme Court has confirmed that the fiduciary common law standards with respect to demand futility must be applied and construed consistently with such contractual and statutory exculpatory provisions. *Stone*, 911 A.2d at 367.

claim, she must plead particularized facts showing "a failure to act in good faith [that] requires conduct that is qualitatively different from, and more culpable than, the conduct giving rise to a violation of the duty of care (i.e., gross negligence)."[113] As the Delaware Supreme Court recently explained, the plaintiff must plead with particularity the following "necessary conditions predicate" for such liability:

> (a) the directors ***utterly failed*** to implement any reporting or information system or controls; *or* (b) having implemented such a system or controls, ***consciously failed to monitor or oversee its operations*** thus disabling themselves from being informed of risks or problems requiring their attention. In either case, imposition of liability requires ***a showing that the directors knew that they were not discharging their fiduciary obligations***.[114]

Plaintiff does not, and cannot, meet this pleading burden. *First*, she does not plead with any factual particularity that the Defendant Directors failed to implement accounting reporting systems or controls. The Complaint, in fact, is replete with specific factual allegations demonstrating that MMA and/or the Defendant Directors established and maintained such systems and controls:

- MMA has an Audit Committee whose principal duties include: "monitoring the integrity of the financial reporting processes and systems of internal controls; monitoring the Company's compliance with legal and regulatory requirements; monitoring the independence, qualifications, and performance of the Company's independent registered public accounting firm and internal audit function."[115]
- MMA considers and applies the accounting directive concerning other-than-temporarily impaired assets (FAS 115) in its financial statements.[116]

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[113] *Stone*, 911 A.2d at 369.

[114] *Id.* at 370 (emphasis added.)

[115] Compl. at ¶ 165.

[116] *Id*. at ¶¶ 61-64.

- MMA evaluated and determined that a November 2005 amendment to FAS 115 "had no material effect on [MMA's] reported financial condition or results of operations."[117]

- MMA performed reviews of the properties collateralizing each bond in its portfolio.[118]

- MMA has an Audit Committee that has reviewed with MMA's management "material weaknesses related to the financial reporting process, including the sufficiency of resources dedicated to the Company's accounting function."[119]

These allegations alone lay to rest any assertion that the Director Defendants "utterly failed" to have information or reporting systems in place. These assertions confirm – rather than refute – that the Board has established and maintained such systems with a conscientious regard for its oversight responsibilities. Thus, Plaintiff has failed to allege particularized facts to support the conclusion that the Director Defendants are "guilty of a sustained failure to exercise their oversight function."[120]

Second, Plaintiff has not pled with particularity that the Director Defendant *consciously* failed to monitor or oversee MMA's operations and accounting practices. The law, in this regard, is clear: A director may not be liable for an alleged failure to prevent wrong doing unless he or she "ignores obvious danger signs."[121] "[A]bsent grounds to suspect deception, neither corporate boards nor senior officers can be charged with wrongdoing simply for assuming the

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[117] *Id*. at ¶ 103.

[118] *Id*. at ¶ 68.

[119] *Id*. at ¶ 148.

[120] *Caremark*, 698 A.2d at 971.

[121] *Baxter*, 654 A.2d at 1270-71.

integrity of employees and the honesty of their dealing on the company's behalf."[122] Thus, "[i]n 'the absence of red flags, good faith in the context of oversight must be measured by the directors' actions 'to assure a reasonable information and reporting system exists' and not by second-guessing after the occurrence of employee conduct that results in an unintended adverse outcome."[123]

The Chancery Court's decision in *Rattner* is instructive on this point. The plaintiff in that case, like Plaintiff here, alleged that director defendants breached their fiduciary duties "by inadequately maintaining accounting controls and utilizing improper accounting and audit practices."[124] The complaint in *Rattner* was strikingly similar to this Complaint. As described by the Court:

> The Amended Complaint sets forth vast tracts of quoted materials from public sources, detailing wrongdoings in the form of alleged misstatements. The Amended Complaint also summarizes numerous SEC rules and regulations, and FASB and GAAP standards. However, conspicuously absent from any of the Amended Complaint's allegations are particularized facts regarding the Company's internal financial controls during the Relevant Period, notably the actions and practices of [the company's] audit committee. The Amended Complaint also is similarly wanting of any facts regarding the Board's involvement in the preparation of the financial statements and the release of financial information to the market.[125]

Here, as well, the Complaint also offers no particularized facts concerning the processes through which the Board was allegedly involved in the financial reporting and accounting and tax compliance practices at issue. It does not, for example, contain any facts describing the

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[122] *Caremark*, 698 A.2d at 969.

[123] *Stone*, 911 A.2d at 372, *quoting, Caremark*, at 967-68, 971.

[124] *Rattner*, 2003 WL 22284323, at *1.

[125] *Id.* at *12.

process through which MMA accounting personnel determined that certain assets should be considered only temporarily impaired; no facts about the nature of the work performed by MMA's Audit Committee or whether any of that work involved this particular accounting statistic; no facts about who, if anyone, advised the Audit Committee and whether any member of the Committee specifically discussed and approved the "other-than-temporarily impaired" treatment of the assets described in the Complaint. Nor does the Complaint offer any particularized facts about MMA's financial controls (other than admitting that such controls exist); about how and who at MMA analyzed and prepared the financial statements related to the value of MMA's bond portfolio; or about the extent to which the Director Defendants were personally involved in preparing and disseminating the financial information at issue.[126]

Instead, the only cognizable inference that can be drawn from reading the Complaint is that MMA has an Audit Committee on which Baum, Brown, Hillman, Mehlman and Pratt serve.[127] This allegation is plainly insufficient to overcome this Motion. Here, as in *Rattner*, Plaintiff's Complaint:

> The only information one can snare from the Amended Complaint is that there exists a body of rules regarding the accuracy of recording and reporting financial information which may have been violated. . . . Therefore, I am unable to conclude that a majority of the Board faces a substantial likelihood of liability for

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[126] *Id.* at *13; *Guttman*, 823 A.2d at 498 (dismissing complaint that lacked particularized facts concerning "the status of the company's financial controls during the Contested Period, including whether the company had an audit committee during that period, how often and how long it met, who advised the committee, and whether the committee discussed and approved any of the allegedly improper accounting practices" and was "devoid of any pleading regarding the full board's involvement in the preparation and approval of the company's financial statements").

[127] Compl. at ¶¶ 4, 6, 8, 12, 13

> failing to oversee [the Company's] compliance with required accounting and disclosure standards.[128]

In addition, like the plaintiff in *Guttman*, Plaintiff here does not allege any "reasons why particular defendants should have been on notice of the accounting irregularities that are alleged."[129] Plaintiff adopts the correct phraseology of the case law by summarily pleading that the Board should have heeded "red flags" but does nothing more than repeat her assertions as to why she thinks the accounting and tax experts should not have reached the conclusions that they did with respect to the valuation of assets, the issuance of dividends, and the propriety of charitable contributions and certain asset transactions.[130] The fundamental failing of the Complaint is not that it lacks sufficient repetition of the accounting and other deficiencies it alleges; rather, it fails because it does not identify any facts that show that such deficiencies were brought to the attention of the Board, that the Board had sufficient reason to think that such deficiencies existed or needed to be addressed, or that the Board failed to reasonably respond to any such information. No such facts exist and none is pled.

Absent particularized allegations that the Board consciously and in bad faith ignored obvious danger signs in reckless disregard for the interests of its shareholders, Plaintiff does not sufficiently plead demand futility on the basis that the Director Defendants confronted personal liability that "absolutely disqualifies them from passing on a shareholder demand."[131]

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[128] *Rattner*, 2003 WL 22284323, at *13; *Guttman*, 823 A.2d at 498.

[129] *Guttman*, 823 A.2d at 498.

[130] Compl. at ¶¶ 70, 161.

[131] Compl. at ¶¶ 174.

C. Demand Was Not Futile Because No Cognizable Injury Has Occurred That Could Give Rise To Any Serious Threat of Potential Liability

Plaintiffs' assertion that the directors cannot impartially consider a demand because they confront potential liability also cannot be reconciled with the Plaintiff's complete failure to plead with particularity the alleged harm that she claims may, someday, befall MMA by reason of the accounting and tax law compliance practices alleged in the Complaint. Without any plausible theory of actual harm to the Company, it is inconceivable that the Director Defendants would be concerned about their potential liability in responding to a demand.

The Complaint lacks even the rote allegations of harm that typify a *Caremark* claim: That the alleged failed oversight led to actual ─ not speculative ─ criminal or civil/regulatory investigations, guilty pleas, fines or other civil liabilities. Because Plaintiff cannot plead any such actual harm to the Company, she instead offers only her speculation that the alleged conduct "*will have caused* the Company to expend substantial sums to respond to investigations and inquiries, federal securities suits and public concerns" or "*will have caused* MMA to incur substantial losses as a result of harm to its public reputation, increased regulatory scrutiny and *potentially* significant financial penalties."[132] Such "conclusory and cryptic allegations" are "insufficient to satisfy the demand excusal requirements of Court of Chancery Rule 23.1" because they "leave[] far too much to the imagination."[133]

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[132] Compl. at ¶ 79 (emphasis added).

[133] *Rattner*, 2003 WL 22284323, at *14. Notably, even in cases where plaintiffs have alleged that actual harm and damages have occurred by reason of substantial government investigations or other civil or criminal liabilities, Delaware courts routinely dismiss *Caremark* oversight claims for failure to plead demand futility because the plaintiff is confusing a "bad outcome with bad faith." *Stone*, 911 A.2d at 372; *see also*, *David B. Shaev Profit Sharing Account v. Armstrong*, Civ. A. No. 1449-N (SPL), 2006 WL 391931, at *3, *5 (Del. Ch. Feb. 13, 2006) (complaint dismissed despite numerous civil suits and investigations
(continued…)

IV. Demand Was Not Futile Because The Complaint Fails To Allege Particularized Facts Sufficient To Show That The Board Made A Decision Not Protected By The Business Judgment Rule

Plaintiff summarily alleges that "[d]emand is futile because the improper acts and practices alleged herein are not subject to the protection of the business judgment rule and would not be ratified, approved, or condoned by disinterested and informed directors under any circumstances."[134] The Complaint, however, either fails to sufficiently plead that the Board actually made an affirmative decision that could be evaluated against the business judgment rule, or it pleads Board action that is fully consistent with rational business purposes expressly recognized or authorized under the MMA Operating Agreement.

As a threshold matter, a plaintiff claiming demand futility in connection with a Board decision must first plead with particularity that a Board decision was, in fact, made. Where "there is no conscious decision by the directors to act or refrain from acting, the business judgment rule has no application" because the absence of board action "makes it impossible to perform the essential inquiry contemplated by *Aronson* – whether the directors have acted in conformity with the business judgment rule in approving the challenged transaction."[135]

(continued…)

and fines by the SEC, New York State, and New York City); *Rattner*, 2003 WL 22284323, at *13 (complaint dismissed despite regulatory investigations and several securities fraud class-action lawsuits); *Beam ex rel. Martha Stewart Living Omnimedia Inc. v. Stewart,* , 833 A.2d 961, 975-76 (complaint dismissed despite criminal indictment and SEC investigations); *In re Citigroup S'holders Litig.*, No. 19827 (SPL), 2003 WL 21384599, at *2 (Del. Ch. June 5, 2003) (complaint dismissed despite company's alleged involvement in the collapse of Enron); *Guttman*, 823 A.2d at 498 (complaint dismissed despite SEC investigation into alleged misconduct).

[134] Compl. at ¶ 162.

[135] *Rales*, 634 A.2d at 933 ("The essential predicate for the *Aronson* test is the fact that a *decision* of the board of directors is being challenged in the derivative suit").

Where a "conscious decision" by a board is shown, a plaintiff "must plead particularized facts sufficient to raise (1) a reason to doubt that the action was taken honestly and in good faith or (2) a reason to doubt that the board was adequately informed in making the decision."[136] This is a "substantial burden" because "the second prong of the *Aronson* test is 'directed to *extreme* cases in which, despite the appearance of independence and disinterest, a decision is so extreme or curious as to itself raise a legitimate ground to justify further inquiry and judicial review.'"[137] This "substantial burden" requires Plaintiff to plead particularized facts establishing that the Director Defendants were grossly negligent in making a conscious decision.[138] Such gross negligence requires a showing that the Director Defendants completely failed to inform themselves, were recklessly indifferent or deliberately disregarded MMA's shareholders, or made a decision wholly "without the bounds of reason."[139] Absent any such "particularized allegations to the contrary, the directors are presumed to have acted on an informed basis and in the honest belief that their decisions were in furtherance of the best interests of the corporation and its shareholders."[140]

Here, Plaintiff alleges that the Board made affirmative decisions approving of: (a) charitable contributions made to non-profit entities; (b) allegedly "improper asset transactions"

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[136] *In re Walt Disney Co. Deriv. Litig.*, 825 A.2d 275, 286 (Del. Ch. 2003).

[137] *Highland Legacy Ltd. v. Singer*, No. Civ. A. 1566-N (SPL), 2006 WL 741939, at *7 (Del. Ch. Mar. 17, 2006) (citations omitted) (emphasis added).

[138] *Grobow v. Perot*, 539 A.2d 180, 190 (Del. 1988) (citation omitted), *overruled on other grounds*, *Brehm*, 746 A.2d 244.

[139] *Tomczak v. Morton Thiokol, Inc.*, C.A. No. 7861 (MAH), 1990 WL 42607, at *12 (Del. Ch. Apr. 5, 1990) (quotation omitted).

[140] *Highland Legacy*, 2006 WL 741939, at *7.

through which the Company earned "enormous profits"; (c) allegedly "excessive dividends"; and (d) the performance-based compensation for Falcone and Joseph.[141] Plaintiff, however, does not allege any particularized, well-pleaded facts sufficient to show that any member of the MMA Board acted recklessly or in deliberate disregard of MMA's shareholders with respect to any of these alleged decisions.

First, Plaintiff does not allege with particularity any reason for this Court to conclude that the Board was grossly negligent in declaring dividends. Plaintiff does not contest that the dividends were paid to all shareholders; nor does she allege that the dividends were paid in breach of the MMA Operating Agreement which expressly authorizes the Board to issue dividends "from cash of the Company which the Board of Directors determines is available for distribution."[142] Moreover, Plaintiff does not, and cannot, allege that MMA ever paid dividends at a time when its liabilities exceeded its assets.[143] Not only does the Complaint fail to plead any facts sufficient to show that the dividends paid to all shareholders were improper under the very agreement and statute that authorizes them, Delaware law is clear that "the declaration and

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[141] Compl. at ¶¶ 33, 114, 172.

[142] Exhibit A at § 5.1.

[143] Instead, Plaintiff claims only that dividends "exceeded cash flow," using "cash flow" figures that excluded, among other things, working capital, an asset that the Board may and should take into account when exercising its business judgement discretion about whether to declare a dividend. 6 Del. C. § 18-607 (a) (prohibiting distributions by a limited liability company only if liabilities exceed assets at the time of the dividend). Plaintiff does not explain this material omission which, if corrected, would refute any notion that the Company's financials do not support its declared dividends since under the very same public filings on which Plaintiff relies, assets substantially exceeded liabilities at all times.

payment of dividends rests in the discretion of the…board of directors in the exercise of its business judgment."[144]

Second, the Complaint does not plead with particularity facts sufficient to show that the Board was grossly negligent in allowing MMA to make charitable contributions. Plaintiff only makes the unsubstantiated assertion that the Board approved of a "scheme" through which the Company would make charitable contributions to non-profit entities which, in turn, would use those contributions to service debt held by MMA.[145] The Complaint, however, does not identify the "related entities" that allegedly received the charitable contributions; nor does it identify any facts to show that funds received by such entities were actually used to service debt held by MMA. And, even if some charitable contributions were ultimately used to fund debt service, there is nothing in the Complaint that would establish that the Board had any involvement in making the decisions about how those funds would be used, or that any such use was unreasonable, irrational, or unsupported by legitimate, lawful business objectives. Such a paucity of allegations is plainly insufficient to support the assertion that MMA's charitable contributions were without a valid and lawful business purpose or that the Board was grossly negligent in approving any such contributions.

The Complaint also fails to adequately plead that the MMA Board made any decision at all about whether MMA charitable contributions should be used to fund debt service. The Complaint, in fact, acknowledges that MMA made its charitable contributions to separate entities which, in turn, would determine the downstream entities that would actually receive and decide

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[144] *Gabelli & Co., Inc. v. Liggett Group Inc.*, 479 A.2d 276, 280 (Del. 1984).

[145] Compl. at ¶¶ 47-56.

how to use the charitable funds.[146] Plaintiff, therefore, does not sufficiently plead a Board decision, much less a "conscious decision" not protected by the business judgment rule.

Third, Plaintiff makes the unusual complaint that MMA should not have made "enormous profits" when it disposed of its investments in three of its hundreds of holdings.[147] Plaintiff claims that these transactions were "improper" solely because they involved related parties who, absent their affiliation with MMA, would not have let MMA shareholders reap the benefits of the enormous appreciation in the value of the underlying real estate assets.

Importantly, the gravamen of Plaintiff's claim is not that the influence of related parties induced a fiduciary breach to the detriment of shareholders; rather, it is that these transactions could potentially expose the Company and its shareholders to tax liabilities that the Complaint only vaguely describes.[148] But there is nothing in the Complaint that demonstrates that the Board had any reason to know that earning these profits for the benefit of MMA shareholders through these transactions could potentially create the speculative tax liabilities to which the Complaint alludes. Absent any such knowledge, and none here is pled, the Board's actions were well-rooted in the legitimate objective of maximizing for MMA shareholders a return on their investment.

The Complaint also fails to allege with particularity its contention that the alleged transactions were "for the defendants' personal enrichment" and served only "to maintain control

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[146] Compl. at ¶¶ 51, 53, 55.

[147] Compl. at ¶ 110.

[148] *See, e.g.*, Compl. at ¶¶ 145-146 (alleging that MMA's realization of profits through its alleged "alter-ego affiliates" could render "tax-exempt proceeds taxable" or expose MMA "to tax fraud charges").

over the assets that would personally benefit each of them."[149] The Complaint itself directly contradicts this assertion, claiming that MMA should have foregone the "enormous profits" it realized and yielded them to the related entities allegedly controlled by Joseph and Falcone.[150] Since, by Plaintiffs' own admission, MMA and its shareholders secured and shared equally in the benefits of the alleged transactions (and *none* of those benefits were ceded to the allegedly related entities), the Board acted reasonably in the exercise of its business judgment and nothing in the Complaint supports the assertion that the Board was grossly negligent or acted in bad faith with respect to these transactions.

Fourth, the Complaint does not make any allegations (factual or legal, specific or conclusory) suggesting that any of the outside directors failed to adequately inform themselves when deciding to approve the performance-based compensation program for Defendants Falcone and Joseph or the transactions between MMA and entities allegedly partially or fully owned or controlled by Falcone and/or Joseph. Nor has Plaintiff alleged any particularized facts suggesting that a majority of the MMA Board members "personally acted without honesty and good faith" in approving the performance-based compensation.[151] Delaware law is clear that,

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[149] *Id*. at ¶¶ 110, 114. Plaintiff claims only that Defendants Falcone and Joseph owned some unspecified minority interests in three properties that served as collateral for bonds maintained by MMA in its portfolio. Beyond these vague assertions, Plaintiff claims only that Joseph (in some way that the Complaint is unable to identify) "controlled" the borrowers on one of the bonds when MMA obtained it in a transaction that occurred in 2001. Based solely on these vague allegations of interests supposedly held by related entities, Plaintiff claims that an unidentified "Joseph-controlled entity was the original borrower" on a bond that originated in 2000. Even if true, none of these allegations explain how the defendants personally benefited from the alleged transactions at the expense of MMA shareholders.

[150] *See, e.g.*, Compl. at ¶ 133 (the alleged related party borrower should have sold the asset, paid off the debt, and "retain[ed] the net gain for itself").

[151] *In re J.P. Morgan Chase & Co. S'holders Litig.*, 906 A.2d 808, 824 (Del. Ch. 2005).

absent such allegations, a plaintiff cannot be excused from making a pre-suit demand under the second prong of *Aronson.*[152]

Therefore, as in *J.P. Morgan Chase*, because of "the absence of particularized factual allegations calling into question the directors' good faith, honesty, or lack of adequate information," the MMA Board's alleged decisions to approve the performance-based compensation and the allegedly interested-party transactions are "entitled to the protection of the business judgment rule."[153]

These same claims also fail under a corporate waste analysis. Plaintiff has not alleged particularized facts that, if true, would be sufficient to establish that the MMA Board acted "on terms that no person of ordinary, sound business judgment could conclude represents a fair exchange."[154] This "extreme test is rarely satisfied, because if a reasonable person could conclude the board's action made business sense, the inquiry ends and the complaint will be

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[152] *Brehm*, 746 A.2d at 261-62 (refusing to excuse pre-suit demand because directors' decision to approve extremely large severance package was "fully protected" by business judgment rule where Directors acted in good faith); *Highland Legacy*, 2006 WL 741939, at *7 (declining to excuse demand under the second prong of *Aronson* because the complaint did not allege sufficient facts showing "that the directors failed to adequately inform themselves" concerning allegedly excessive compensation paid to two financial advisors); *J.P. Morgan Chase*, 906 A.2d at 824 (declining to excuse demand because "[n]othing in the complaint indicates that the JPMC Board was not adequately informed" about the merger negotiations); *Litt v. Wycoff*, C.A. No. 19083-NC (JWN), 2003 WL 1794724, at *10 (Del. Ch. Mar. 28, 2003) (refusing to excuse pre-suit demand because Plaintiff had failed in challenging incentive-based compensation to make "particularized allegations about 'comparable compensation at comparable institutions' or that the [executive compensation] 'was disproportionate to the services rendered' ").

[153] 906 A.2d at 825.

[154] *Green v. Phillips*, Civ. A. No. 14436 (JBJ), 1996 WL 342093, at *5 (Del. Ch. June 19, 1996), *quoting Steiner v. Meyerson*, Civ. A. No. 13139 (WTA), 1995 WL 441999, at *1 (Del. Ch. July 19, 1995).

dismissed."[155] As this Court has observed, the correct corporate waste standard requires Plaintiff to allege "particularized facts showing that the corporation, in essence, gave away assets for no consideration."

Here, Plaintiff has not alleged any facts to suggest that the MMA Board "gave away corporate assets for no consideration" with respect to either the performance-based compensation or the alleged interested-party transactions. Plaintiff's claims, therefore, must be dismissed under the second prong of *Aronson* because pre-suit demand cannot be excused.

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[155] *Green*, 1996 WL 342093, at *5.

CONCLUSION

For the foregoing reasons, Plaintiff does not, and cannot, meet her stringent burden of pleading particularized facts sufficient to excuse pre-suit demand. The Complaint should be dismissed with prejudice accordingly.

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