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 Defendant.

C.A. No. 2404-VCL

DEFENDANTS' REPLY TO PLAINTIFF'S SURREPLY IN FURTHER SUPPORT OF DEFENDANTS' MOTION TO DISMISS THE AMENDED SHAREHOLDER DERIVATIVE COMPLAINT

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August 7, 2007

Pursuant to the Court's Order dated July 24, 2007, Defendants in the above-captioned matter respectfully submit this response to Plaintiff's Surreply in Further Opposition to Defendants' Motion to Dismiss the Amended Shareholder Derivative Complaint ("Surreply").

Referencing and attaching recent public disclosures made by Nominal Defendant Municipal Mortgage & Equity, LLC ("MMA"), Plaintiff's Surreply focuses on the immaterial assertion that the Company's earnings restatements are related to the accounting practices alleged in the Complaint. Even if the restatements relate in some way to the matters alleged in the Complaint, the mere fact that the Board has taken action to correct accounting errors brought to its attention cannot salvage Plaintiff's deficient oversight claims.[1]

As an initial matter, the recent disclosures Plaintiff identifies in her Surreply directly contradict the allegations of her Complaint. Specifically, the disclosures explain that MMA previously had ***undervalued*** some of the assets in its tax-exempt portfolio whereas the Complaint alleges that MMA incorrectly ***overvalued*** such assets.[2] Thus, the only thing the disclosures make clear is that MMA's prior valuation of assets was too conservative -- not, as Plaintiff would have it, deceptively inflated.

But even if the restatements and disclosures reflected the specific accounting errors alleged in the Complaint, such a fact would not, as Plaintiff suggests, support an inference that the Director Defendants failed to exercise appropriate oversight.[3] As the Delaware Supreme

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1 Surreply at 3. Notably, plaintiff now concedes that she is asserting oversight claims, even though she previously complained that Defendants "mischaracterized" her claims as oversight claims. Opp. at 25.

2 *Compare* Compl. ¶¶ 69-70 (alleging that MMA improperly applied an accounting statistic to ***inflate*** the value of certain tax exempt bonds) with Surreply at Exh. A (reporting that the audited financial statements corrected "for errors related to the Company's estimation of the fair value of bonds" that had previously ***undervalued*** the shareholders' equity in Muni Mae's TE Bond Subsidiary by some $52.9 million).

3 Surreply at 3.

Court explained in *Stone v. Ritter*, the fact that a company's internal controls were, in hindsight, inadequate "is not alone enough for a court to conclude that a majority of the corporation's board of directors is disqualified from considering demand."[4] Otherwise, demand automatically would be excused in *every* case involving a restatement of earnings.

Rather, the question before the Court is whether Plaintiff has plead particularized facts sufficient to show that the Director Defendants ***knew*** that accounting problems existed ***and ignored them***.[5] On this point, nothing in the Complaint or Surreply indicates that any member of the MMA Board, much less a majority of them, knowingly permitted accounting irregularities to occur.[6] Indeed, the restatements themselves came about only because the Company ***had accounting and reporting controls in place*** that allowed the Board to discover and respond to bona fide accounting concerns. This Court should applaud, and not condemn, such candor and vigilance.

Because Plaintiff, like the plaintiff in *Stone*, failed to plead particularized facts "showing that the board was ever aware that [the Company's] internal controls were inadequate, that these inadequacies would result in illegal activity, and that the board chose to do nothing about

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4 911 A.2d 362, 371 (Del. Ch. 2006).

5 *See id.* at 370; *Guttman v. Huang*, 823 A.2d 492, 506 (Del. Ch. 2003) (stating that oversight liability is premised "on a showing that the directors were ***conscious*** of the fact that they were not doing their jobs.") (emphasis added); *Rattner v. Bidzos*, No. Civ. A. 19700 (JWN), 2003 WL 22284323, at *13 (Del. Ch. Oct. 7, 2003) (granting motion to dismiss where "[t]here is nothing alleged in the Amended Complaint that would either demonstrate or permit [the court] to draw the reasonable inference that the Director Defendants were ***aware*** of [accounting problems]") (emphasis added).

6 Without a single fact indicating such knowledge or a failure to act, Plaintiff likens the entire MMA Board to an "arsonist" trying to put out a fire. Surreply at 3, n.5. This hyperbolic attempt to attribute criminal intent to the MMA Board is no substitute for pleading demand futility with particularity.

problems it allegedly knew existed," Plaintiff's failure to make a pre-suit demand should not be excused and the Complaint should be dismissed with prejudice.[7]

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[7] 911 A.2d at 370.

CERTIFICATE OF SERVICE

It is hereby certified that on August 7, 2007, a copy of the foregoing DEFENDANTS' REPLY TO PLAINTIFF'S SURREPLY IN FURTHER SUPPORT OF DEFENDANTS' MOTION TO DISMISS THE AMENDED SHAREHOLDER DERIVATIVE COMPLAINT was served on the following counsel of record in the manner indicated:

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