EFiled: Jun 26 2007 4:57PM EDT
Transaction ID 15371186
Case No. 2404-VCL

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 **PUBLIC VERSION**

PLAINTIFF'S OPPOSITION TO DEFENDANTS' MOTION TO DISMISS THE AMENDED SHAREHOLDER DERIVATIVE COMPLAINT

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OVERVIEW

Municipal Mortgage & Equity LLC ("MMA" or the "Company") is a sub-prime, junk bond lender. Plaintiff's Amended Shareholder Derivative Complaint (the "Complaint") details the Company's sordid business history consisting of insider dealings, earnings management, unsupported dividend distributions, the use of improper asset transfers, and internal policy and accounting violations, to boost the appearance of the performance of its tax-exempt debt portfolio.[1] Defendants explicitly approved a myriad of improper insider transactions and false disclosures, despite overwhelming "red flags" giving notice to the inappropriateness of the actions and the increasingly dire financial condition of the Company and its key tax-exempt debt portfolio. To assist Defendants in their deceptive confidence game with the financial markets, Defendants caused the Company to systematically reduce the transparency of its disclosures, avoid write-downs on its dismally performing loan portfolio, and contravene the already inadequate internal controls and policies of the Company. The internal deterioration of the Company has necessitated what will be a 21-month restatement process.

Company Foundation Relies on Confidence in its Capital. To address the financial distress from which MMA originated,[2] the Company relied heavily on outside financing sources including credit lines, and debt and equity issuances. ¶25. Access to financing is impacted by the performance of the underlying assets of the Company as well as the share price, which Defendants have bolstered by continually increasing the dividend. ¶¶26-29. In light of the non-performing assets serving as MMA's foundation, the Company at its outset was distributing more cash than it was able to generate, making access to outside financing indispensable.

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[1] References are to the Complaint. References to public filings noticeable by the Court are made herein, and may be considered in limited circumstances for establishing statements by the Company. *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 169 (Del. 2006); *In re Santa Fe Pacific Corp. S'holder Litig.*, 669 A.2d 59, 70, n.9 (Del. 1995).

[2] Of the 22 properties securitizing the tax-exempt debt which was transferred to MMA at its formation, 16 were non-performing. As with all of the related-party transactions, these required approval of the Board of Directors of MMA pursuant to the Company's charter. ¶ ¶56, 117, 160, 161(j), 161(s)(a)(v).

According to the Company's 1996 Annual Report, filed March 25, 1997 on Form 10-K, the Company's distributions exceeded cash flow by $462,000, $8.244 million, and $5.766 million in 1994, 1995, and 1996, respectively.

Defendants have continued to direct and authorize the Company's distributions which exceed cash flow and require the Company to incur additional liabilities. ¶¶ 30, 34-37. After adjusting Cash Flow from Operations by accounting for non-cash flow generating accounting entries,[3] the Company has distributed approximately $44,091,000 more in dividends than it has generated in distributable cash flow. ¶30. Using the Company's reported financial data, without making adjustments, operating cash flow was less than distributions for most quarters:[4]

(in thousands)	**2001**			**2002**			**2003**	
	Operating Cash Flow	Distributions		Operating Cash Flow	Distributions		Operating Cash Flow	Distributions
1st Q	8,631	11,955		7,866	12,791		24,903	14,329
2nd Q	21,753	12,244		12,231	14,140		29,699	15,840
3rd Q	12,637	12,267		19,143	14,098		-3,391	15,974
4th Q	-11,570	12,368		-7,789	17,805		15,190	14,595
Total	31,451	48,834		31,451	58,834		66,401	60,738
	2004			**2005**				
1st Q	13,123	14,770		-17,389	17,391			
2nd Q	14,023	15,919		17,666	18,795			
3rd Q	12,954	32,525		29,691	19,359			
4th Q	14,041	-33		17,243	15,887			
Total	54,141	63,181		47,211	71,432			

To maintain its dividend and further increase its asset base in an effort to compensate for the non-performing assets, Defendants caused the Company to serially issue debt and equity to pay the excessive dividend in order to borrow time to allow new loans and fee generation

[3] Defendants assert that Plaintiff has "altered" financial data to plead excessive dividends. Plaintiff has merely used a more accurate measure for determining cash flow available for distribution by adjusting for accounting entries that do not affect the cash available for dividends, such as changes in assets and liabilities. This lessens the ability of the Company to change the appearance of its Cash Flow from Operations by merely making adjustments to its assets and liabilities, a particularly problematic and common practice within the Company as evidenced by significant variations in the Company's past assets and liabilities among its Annual Reports.

[4] Defendants' insinuation that a different outcome concerning excessive dividends would be rendered by examining quarterly distributions, Defs. Br. At 9 n.26, is inaccurate despite the significant variations among quarterly reports concerning same period distributions that seemingly indicate the lack of reliability, and usefulness to the shareholder and MMA, of the Company's financial statements. ¶35, n.1-2, 82-83.

businesses to compensate for the non-performing assets. ¶¶34-39. This resulted in a tremendous increase in MMA's asset base, from $230 million in 1996 to $1.2 billion in 2001 to $3.8 billion in 2005, albeit through excessive debt issuances and credit lines, ¶¶23, 35.

The Company's dismal loan portfolio issues worsened. Amidst a falling interest rate environment, its dividend yield exceeded the interest earned on most of its bond and loan investments, ¶¶40, 50, causing the Company to make ever riskier loans. ¶38-39. The number and face-value of loans on non-accrual increased, ¶¶41-42, 45-46, 72-73, 75, while the debt service coverage ratio for the properties collateralizing the bonds worsened. ¶¶42-43, 72, 100. The increase in loan defaults further exacerbated the Company's operating cash flow/dividend disparity and impacted earnings. ¶30. Since the Company was dependent on continual debt and equity issuances to finance the dividend and compensate for its non-performing assets, it was necessary for the Company to maintain the confidence of the financial markets. ¶¶25-27, 34-36, 39. To do so, the Company could not cut the dividend (it, consistently and boastfully, increased the dividend regardless of operating cash flow, ¶29), declare poor earnings or disclose the extent of the deterioration of its tax-exempt bond portfolio. ¶¶ 25-27, 29.

Earnings Management. To enhance the appearance of MMA's financial performance, Defendants failed to properly account for the true value of MMA's tax-exempt debt and authorized the Company to engage in transactions that enhance and smooth earnings. ¶¶85-134.

Improper Asset Transactions. Defendants caused, and authorized, the Company to execute numerous improper related-party transactions[5] involving impaired debt that smoothed

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[5] Pursuant to the Company's Certificate of Formation and Operating Agreement Article 7.1(c) (Ex. A to Defendant's Opening Brief in Supp. of Motion to Dismiss [Defs. Br."]), the Board was required to approve all related-party transactions. ¶¶56, 117, 160, 161(j), 161(s)(a)(v), as summarized in MMA's 2006 Annual Report:

> Review and Approval of Transactions with Related Persons.
> Our operating agreement provides procedures for the approval of transactions with related persons which include approval of such transactions by a vote of the majority of the disinterested members of our board of directors. All transactions involving us or any of our subsidiaries, on the one hand, and any of our directors

earnings and inflated the Company's financial performance during lackluster quarters. ¶¶110-134. Plaintiff complains of three non-cash asset transactions involving related party borrowers.[6] Each began with foreclosures of properties held by entities controlled by, or affiliated with, Defendant Joseph. ¶¶118, 122, 126. Each had been in default some ten years before[7] and each of the loans had been on non-accrual status even while the Company reported their fair value estimates as exceeding the loan basis. ¶¶121, 123, 127. Following each belated foreclosure was a near immediate resale resulting in enormous profits. ¶¶110-134. The net income attributable to the transactions accounted for approximately 83%, 94% and 46% of the respective quarter's net income during which they were recorded. ¶111. These transactions run contrary to the Company's representations that its deed in lieu of foreclosure transactions are to entities with sufficient independence from the Company to maintain the interest income as tax-exempt. The fact that purported gains from independent entities have been conveniently transferred to the Company to achieve earnings objectives demonstrates the related party nature of the transactions and evinces the improper tax-exempt treatment of a significant portion of the Company's debt. ¶¶134, 136-146.

Further acting under the direction and dominance of Defendants Joseph and Falcone, the Defendants also directed the Company to act in concert with a Joseph-related entity, The Shelter Foundation, to assume $33.9 million in financial liabilities of Defendant Joseph and Falcone's failed personal venture, the Village of Stone Mountain. ¶135. Having never been able to meet its

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or officers, or entities in which any of them have a financial interest, on the other hand are approved through this process, including all transactions between us and the Shelter Group. Additionally, all property management arrangements with the Shelter Group are approved by a vote of the majority of the disinterested members of our board of directors on an annual basis after considering the market rate for the services provided by the Shelter Group and other applicable factors.

[6] As related-party transactions, ¶¶118, 122, 126, they had to be reviewed and authorized by Defendants. ¶¶114, 116.

[7] The Company **did not disclose that these related party bonds had been in default u**ntil it reported the gain from the asset sales, further evincing its improper disclosure practice concerning the value and performance of its bonds.

annual debt service obligations, Stone Mountain eventually wound up unsuccessfully offered in the Company's 2006 distressed portfolio offering – with the Company once again postponing the recognition of the loss it assumed for the benefit of Joseph. ¶135.

Improper Treatment of Distressed Assets

> "[I]f the value of our investments in tax-exempt bonds pledged as collateral for securitization programs decreases significantly, we may be required to post cash or additional investments as additional collateral for such programs. In the event that we have insufficient liquidity or unencumbered investments to satisfy these collateral requirements, the securitization programs may be terminated and the pledged collateral liquidated to satisfy the obligations to the holders of the securitization program certificates. In such cases, we would lose the cash flow from the tax-exempt bonds and our ownership interest in them, and our financial condition and results of operations could be materially adversely affected."

2005 Annual Report. Throughout the relevant period, the Company's tax-exempt debt portfolio and the property securitizing the debt exhibited substantial deterioration, ¶¶24, 40-46, 72-73, 75, 86-91, which was concealed and misrepresented through the utilization of charitable contributions to prop up loan payments. ¶¶47-56. Yet, the Company recorded other-than-temporary impairment charges of only $27.337 million during a 7 year period. ¶74.

The Defendants did nothing about the ongoing deterioration of the performance of a significant portion of the Company's tax-exempt debt portfolio and the deterioration in the securitizing assets except hide the extent of the deterioration, fail to properly account for such non-performing debt and direct the Company to maintain the deteriorating assets so as to not be forced to incur the substantial losses sales of the assets would inevitably bring. ¶¶46-47, 57-75.

The extent of Defendants' improper scheme became evident in early 2006 as the Company attempted to sell a portfolio of $182 million worth of its non-performing assets (the "MMA Portfolio Offering"). ¶¶86-92. The MMA Portfolio Offering materials made clear that this material portion of the Company's tax-exempt debt portfolio had been extensively non-performing for at least 4 years. ¶86. Cash flows of these properties before debt service was approximately 45% of the amount required for full debt service – nowhere near able to meet debt service. ¶87. The initial bids for the bonds, solicited from a significant number of tax-exempt bond investment firms, indicated that the actual value is 50% of what the Company has reported. ¶91. The Company subsequently withdrew the assets from sale because "the bids were too low and the Company could not afford to take a loss." ¶¶88, 92. Despite that such bids provide a reasonable approximation of the value of the bonds, the Company has neither informed investors of any details concerning the auction nor recorded adjustments to the assets as is required. ¶¶88, 93, 107. Rather, Defendants have continued to authorize and issue overly optimistic statements concerning the Company's dividend and financial performance.

In addition to failing to disclose material information concerning the MMA Portfolio Offering, despite passively mentioning it during an April 12, 2006 teleconference, as required due to the materiality of the events and its importance in providing a fair and accurate picture of the Company's financial position, the Defendants have caused the Company to violate numerous accounting principles,[8] SEC Regulations,[9] and the Company's own internal controls and policies by failing to take other-than-temporary impairments. ¶¶93-109. The Company's own internal

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[8] Section 13(b)(2) of the Exchange Act requires every reporting company to maintain books, records and accounts which, in reasonable detail, accurately and fairly reflect the transactions and disposition of the assets of the issuer. GAAP provisions further provide that reported financial results must: provide information that is useful to present and potential investors in making rational investment decisions (FASB Statement of Concepts No. 1, ¶34); comply with the principle of materiality, which provides that the omission or misstatement of an item in a financial report is material if, in light of the circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person would have been influenced by the item (FASB Statement of Concepts No. 2, ¶32; comply with the principle of completeness meaning that nothing is left out of the financial report that may be necessary to ensure that it validly represents underlying events and conditions (FASB Statement of Concepts No. 2, ¶80); and comply with the principle that conservatism be used as a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in the business are adequately considered. FASB Statement of Concepts No. 2, ¶¶95, 97.

[9] Item 7 of Form 10-K and Item 2 of Form 10-Q requires the issuer to provide information required by Item 303 of Regulation S-K [17 C.F.R. 229.303], which, in part, requires the issuer to "[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on . . . revenue or income from continuing operations." Instructions to 303(a) state that "[t]he discussion and analysis shall focus . . . on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results." "It is the responsibility of management to identify and address . . key variables and other . . . factors which are peculiar to and necessary for an understanding and evaluation of the individual company." Securities Act Release No. 6349, at 964.

policies and controls have proven not only inadequate, but were circumvented and ignored at the direction and under the watch of the Defendants. ¶¶59, 87, 89, 98-101, 147-155. In addition to the Company's own policies which required the Company to revalue the non-performing assets, ¶¶98 (where the Company believes it is probable that it will not collect all amounts due); ¶¶89, 100 (fair values derived from methodologies estimating amounts investment could presently obtain in a sale); ¶¶59, 99 (reliance upon external sources, such as an auction, or cash-flow models to value bonds), numerous accounting standards and guidance required the recording of other-than-temporary impairments on these assets, ¶¶61-69, 87, 93-96, 101, 103-105, and the reevaluation of all of the Company's non-performing assets. ¶¶97-97, 105.

Despite acknowledging the controlling accounting guidelines, ¶61-64, 103, Defendants have ignored their application by unjustifiably professing that the Company has "the ability and intent to hold the security until recovery." Defs. Br. at 11. However, the Company demonstrated it had no intent to hold the non-performing assets comprising the MMA Portfolio by the very act of the attempted sale.[10] ¶¶86, 92, 96. In addition, the auction alone required it to reevaluate all of its non-performing bonds, not just those in the offering. ¶¶97-98, 105.

The Company has also demonstrated that it does not have the intent or ability to hold the securities by virtue of its securitizing most of its tax-exempt debt, including those in default.[11] ¶¶23, 95. The terms of the securitization agreements transfer control of the disposition of the securitized assets to the securitization trustee, thereby relinquishing the ability of the Company to hold "until recovery". This is further cemented by the Company's inability to cure securitization

[10] The reference to the pending sale during the April 12, 2006 teleconference is yet another affirmative statement that the Company had no intent to hold the loans comprising the MMA Portfolio Offering.

[11] According to the Company's 2005 Annual Report, "most of our assets are pledged as collateral" and "approximately $1.2 billion, or 86.8% of the fair value, of our investments in bonds . . . were either deposited in securitization trusts or pledged as collateral for short-term and long-term securitization programs."

defaults due to its financial position and its pledging virtually all pledgeable assets.[12]

Much of the Company's investments are financed "through securitization transactions where [it] sell[s] senior interests in [its] assets (including tax-exempt bonds) and retain subordinate interests." 2005 Annual Report. As a result of the securitization, the trustees of the securitization trusts are ultimately the parties who decide whether a defaulted property is liquidated ("In the event a securitization trust cannot meet its obligations, all or a portion of the deposited tax-exempt bonds may be sold to satisfy the obligations to the holders of the senior interests."). In addition, the Company concedes that it can be "forced to sell investments on unfavorable terms" as a result of the illiquidity of the tax-exempt bond assets. *Id*. Consequently, by the Company's own statements, it does not have the ability to hold non-performing assets as that decision has been relinquished to others through the securitization process.

The Company's independent registered public accountant during the relevant period, Pricewaterhouse-Coopers (PwC), has also taken a public position on the recording of other-than-temporary impairment in the context of a holder's ability and intent to maintain the asset that is consistent with Plaintiff's and raises serious questions of fact concerning Defendants' reliance on outside experts.[13] *See, infra,* p. 41-42. Among its reported conclusions are that where a third party controls or manages the securities, akin to the investors in the securitization, the owner typically does not have any control over the sale of the investments and is thus unable to demonstrate ability and intent to hold a security until recovery, which thereby precludes preparers from concluding that impairments are temporary.

Given the clear deterioration of the Company's tax-exempt debt portfolio, ¶¶40-45, 71-

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[12] The Company concedes in its 2005 Annual Report that its "ability to remedy defaults inside the trust is limited."

[13] March 21, 2007, PwC's "Financial Services Technical Hot Topics Webcast" addressing "Other-Than-Temporary-Impairment for Securities Held in Nuclear Decommissioning Trusts and Other Similar Arrangements" which included as its guidance a PwC report covering the SEC staff's view regarding the "'Ability to Hold a Security Until Recovery' For Purposes of Assessing Other-Than-Temporary Impairments of Investments, Including Nuclear Decommissioning Trust Funds." Attached hereto as Ex. A.

73, the utilization of charitable contributions to maintain performance of bonds otherwise in default, ¶¶47-56, and the significant decline in the market value of the assets securitizing the MMA Portfolio Offering bonds, ¶¶86-92, the Company has improperly accounted for the value of these tax-exempt assets and falsely represented its performance. ¶¶57-71, 93-109.

While the shareholders remain in the dark, the Company continues to suffer foregone opportunities and lost income as a result of its being directed to maintain and support these non-performing assets. Although the Company has only taken $27.337 million in other than temporary impairment charges since 1998, ¶¶46, 74, it is clear the losses incurred are substantially greater. ¶¶24, 41-42, 45-46, 75, 90-92. Contrary to Defendants' position, Defs. Br. at 12, the Company has clearly failed to "receive all amounts due" on bonds that Plaintiff has alleged have not been fairly valued. In 2005 alone, the Company did not receive $15.2 million in income as a result of $266 million of debt on non-accrual. ¶46. The 2004 Annual Report provides that at December 31, 2004, 2003 and 2002, $185.5 million, $136.7 million and $115.5 million (face value), respectively, of tax-exempt bonds and loans were on non-accrual status which would have resulted in foregone interest income due to their non-accrual status of approximately $6.0 million, $3.7 million and $1.2 million for the years ended December 31, 2004, 2003 and 2002, respectively. ¶45.[14] The MMA Portfolio Offering materials establish the severe delinquency of approximately $182 million in tax-exempt debt being offered. ¶¶86-87.

Defendants' breaches of fiduciary duties and affirmative actions threaten to unravel MMA and have resulted in substantial harm to the Company. In addition to the aforementioned

[14] Defendants assert that the Company has not "restated" financials related to the performance of the tax-exempt bond portfolio. Defs. Br. at. 3. In fact, the Company has made extensive restatement of numerous material financial figures related to the tax-exempt bond portfolio. For example, in the 2005 Annual Report, the Company has made material adjustments to past figures of bonds on non-accrual status. Compare the 2004 Annual Report, *supra*, to the 2005 Annual Report ($201.8 million, $108 million and $102 million for 2005, 2004, and 2003, respectively, and that the interest not recognized on bonds in non-accrual status was $11.6 million, $3.1 million and $2.3 million for 2005, 2004, and 2003, respectively. These figures are static figures that should not be subject to significant variations for any one point time as the designation of a bond on non-accrual is definite and clear. ¶¶45-46. *See also* ¶¶82-83 (significant restating of past financial figures).

direct losses, MMA is subject to tax fraud charges, and shareholders are exposed to potential significant tax liabilities, as a result of the improper ownership and treatment of the tax-exempt bonds caused by Defendants' juggling of assets to smooth earnings. ¶¶26, 137-146. In addition, MMA has incurred substantial expenses, distractions and harm to its ability to carry out its business and access the financial markets as a result of the gross mismanagement of MMA and the failure of Defendants to adequately monitor MMA and oversee the effectiveness of its internal controls and policies. MMA has had to withdraw a 348,204 common share offering that would have netted the Company cash of no less than approximately $9.3 million, and a $431,736,750 debt offering. ¶155. On December 5, 2006, MMA announced in a current report with the SEC that U.S. Bank reduced its line of credit from $310 million to $180 million. On January 5, 2007, MMA announced, in a current report filed with the SEC, a sale of $176 million in notes to an affiliated REIT, MRC Mortgage and Investment Trust (formerly MMA Affordable Housing Group Trust). This actually served as a debt curtailment with no cash to MMA because the fair value received by MMA ($176 million) was the cancellation of existing debt - two lines of credit to the REIT from Bank of America (BoA) were cancelled and the REIT terminated its line of credit to MMA. On May 18, 2007, in a current report filed with the SEC, MMA announced that BoA reduced its line of credit from $250 million to $100 million, further curtailing MMA's access to capital. According to a May 4, 2007 announcement, MMA admits it has halted operating key parts of its business as it is unable to access sources of capital necessary to originate mortgage loans sold to government sponsored enterprises until at least the completion of its audited financials of two key subsidiaries, including that which is largely charged with MMA's tax-exempt debt. See Ex. B. MMA has also been subjected to a "non-public, informal inquiry" by the SEC since at least its first disclosure in January 2007, and which continues as of May 4, 2007. ¶159, 172, 184. And, MMA has had to expend substantial resources during what will be a 21-month restatement process covering ***three*** restatements during that time period. *See, infra* at p. 28-31 The extent, scope and number of the restatements evidence the clear deterioration of MMA's internal controls and policies, and Defendants' abandonment of their fiduciary duties.

Defendants want this Court to believe that they, themselves experts in this area who actively participated in the wrongdoings that have damaged the Company, are able to consider a demand and, respectively, make affirmative decisions in the best interests of the Company to seek recourse for the extreme damage done to the Company. The Defendants, whose fiduciary duties required them to adequately oversee the Company, cannot be entrusted to lead the recovery efforts to ensure that the Company is made whole as a result of their own abdications of duties. Demand is futile. Defendants' motion to dismiss should be denied.

ARGUMENT

I. Plaintiff Adequately Alleges Demand Futility

A. Standards for Demand Futility

Where a shareholder does not make demand upon a board, Ch. Ct. R. 23.1 requires a shareholder to set forth specific factual allegations detailing why such a demand would be futile. *Rales v. Blasband,* 634 A.2d 927, 934 (Del. 1993). Demand is futile when a "reasonable doubt exists that the board is capable of making an independent decision to assert the claim if demand were made." *Grimes v. Donald*, 673 A.2d 1207, 1216 (Del. 1996); *In re Cendant Corp. Deriv. Action Litig.*, 189 F.R.D. 117, 128 (D.N.J. 1999).[15] Contrary to Defendants' assertions, the demand futility hurdle is not especially high. *See Grimes*, 673 A.2d at 1217 n.19. In assessing

[15] Reasonable doubt "is sufficiently flexible . . . to provide the stockholder with 'the keys to the courthouse' in an appropriate case where the claim is not based on mere suspicions or stated solely in conclusory terms," *Grimes*, 673 A.2d at 1217, and "is akin to the concept that the stockholder has a 'reasonable belief' that the board lacks independence or that the transaction was not protected by the business judgment rule." *Id.* at 1217 n.17.

demand, all reasonable inferences must be drawn in the light most favorable to Plaintiff. *McCall v. Scott,* 239 F.3d 808, 816-17, 824 (6th Cir. 2001). A determination of demand futility is to be based on the ***totality of the*** *circumstances*. *Rales,* 634 A.2d at 934. Plaintiff is not required to plead evidence; nor is proof of success on the merits required at this stage of the litigation. *Rales*, 634 A.2d at 934; *In re Veeco Instruments, Inc. Secs. Litig.*, 434 F.Supp. 2d 267, 276 (S.D.N.Y. 2006) (Plaintiff need not demonstrate a probability of success on the merits). Where there are disputed facts concerning the domination and control by directors, they "should be resolved only after a trial at which all of the facts are presented and the credibility of the witnesses tested. *Telxon v. Meyerson,* 802 A.2d 257, 264 (Del. 2002). In fact, at this stage of the litigation, "dismissal is inappropriate unless plaintiff would not be entitled to recover under any reasonable conceivable set of circumstances susceptible of proof." *Ryan v. Gifford,* 918 A.2d. 341, 357 (Del. Ch. 2007).

There are two tests to determine whether demand is futile: "*Aronson*" and "*Rales*" tests. *See Ryan*, 918 A.2d at 351-352. When the claim involves a contested transaction, *Aronson* applies and finds demand as futile where "a reasonable doubt is created that: (1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984). When the claim does not involve "a conscious decision by directors to act or refrain from acting," the *Rales* test applies. *Rales*, 634 A.2d at 933. Under *Rales,* demand is futile where there is a reasonable doubt that a majority of the directors would have been independent and disinterested when considering the demand. *Ryan,* 918 A.2d. at 355.; *Veeco,*, 434 F.Supp. 2d at 274 (plaintiff need only establish a reasonable doubt that the board could have properly exercised its independent and disinterested business judgment in responding to a demand). Where allegations involve both affirmative misconduct and nonfeasance, as here, "the entire course of action and inaction followed by the Defendants must be considered." *In re Oxford Health Plans, Inc. Sec. Litig.*, 192 F.R.D. 111, 116 (S.D.N.Y. 2000).

B. No Demand Was Required

Plaintiff has alleged particularized facts that sufficiently raise a reasonable doubt that a majority of the Board is capable of objectively considering and investigating the claims Plaintiff has brought on behalf of MMA. At the time Plaintiff commenced this action, the Board consisted of 10 individuals: Baum; Berndt; Brown; Falcone; Hillman; Joseph; Lucas; McGregor; Mehlman; and Pratt[16] (the "Director Defendants"). Plaintiff need only raise a reasonable doubt as to the independence and disinterest in regards to the challenged conduct of ***six*** of these individuals. *Ryan,* 918 A.2d at 351. Plaintiff has made this showing as to all of the Defendants.

Demand on Joseph and Falcone is futile as each is *per* se an "interested director" as a result of having received a material personal benefit from the challenged transactions which were not shared with other shareholders and also having stood on both sides of numerous challenged transactions. *Orman v. Cullman,* 794 A.2d 5, 25 (Del. Ch. 2002). Demand on Berndt is futile because he is *per se* an "interested director" by virtue of his position within a law firm which obtains substantial economic benefits through its relationship to MMA.[17]

Plaintiff was not required to make a demand on the remaining Director Defendants because each has extensive intertwining business and personal relationships that render them beholden to Defendants Joseph and Falcone and one another, because their approval of the transactions was so egregious on its face that the Board's approval cannot meet the business judgment test, and each is subject to substantial likelihood of director liability for breaching his duties of loyalty and good faith to the Company by, among other things: (i) authorizing improper

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[16] Banks is a non-director defendant. Plaintiff need not demonstrate his disinterestedness.

[17] MMA also admits that Joseph, Falcone, and Berndt are interested directors in its proxy filings.

asset transactions which also acted to smooth earnings; (ii) authorizing the Company to acquire and maintain liabilities for the benefit of certain officers; (iii) directing and authorizing the Company to assume excessive liabilities to maintain excessive dividends; (iv) engaging in the accounting improprieties at the Company including acts to conceal the true deterioration of non-performing assets and failure to properly value non-performing tax-exempt debt holdings; (v) failing to ensure the adequacy and accuracy of corporate financial statements and communication with shareholders; (vi) permitting and authorizing the Company to improperly treat its critical tax-exempt assets; (vi) failing to preserve MMA's regulatory compliance and reporting duties as necessary to continue carrying out its stated business purposes; and (vii) failing to remain informed as to the operations of MMA and ensure the adequacy and enforcement of the Company's internal controls and policies. *See also* ¶16; *Aronson*, 473 A.2d at 815.

1. Defendants Lack Independence to Consider Demand

The remaining Director Defendants lack the requisite independence to consider a demand because they have a number of mutually-advantageous business and personal relationships with MMA, its affiliated entities, Joseph, Falcone, and among themselves. A director may be shown not independent if he or she is "dominated by another party, whether through close personal or familial relationship, or through force of will and decisions made under such circumstance will not be protected by the business judgment rule." *Telxon,* 802 A.2d at 264; *Orman*, 794 A.2d at 25 n.50; *Aronson*, 473 A.2d at 816. (independence requires consideration of the merits of the demand rather than extraneous considerations or influences). A lack of independence has been found where there is a "history of personally beneficial affiliation" or a clear pattern of mutually-advantageous business and personal relationships between interested directors and other board members. *Kahn v. Tremont Corp.*, No. 12339, 1994 WL 162613, at *5 (Del.Ch. April 21, 1994); *Rales*, 634 A.2d at 937 (demand futile where particularized facts such as mutual financial interests create reasonable doubt that directors are capable of acting independently of dominant members); *See, e.g.*, *In re New Valley Corp. Deriv. Litig.*, No. 17649, 2001 WL 50212, at *7 (Del. Ch. Jan. 11, 2001) (lack of independence found where "current or past business, personal, and employment relationships" among directors was alleged); *Harbor Fin. Partners v. Huizenga*, 751 A.2d 879, 889 (Del. Ch. 1999) ("long-standing pattern of mutually advantageous business relations" with interested director sufficient to demonstrate lack of independence).

Defendants maintain numerous close, personal and business relationships which cast reasonable doubt upon the independence of MMA Board members and render demand futile. All 10 named Director Defendants have intertwining relationships through ongoing business relationships and leadership positions in both social and economic organizations that create a strong shared financial interest and personal allegiance to Defendants Joseph and Falcone, and among one another. As detailed in numerous public filings, Defendants have the following intertwining business relationships:

- Boston Financial Group: Joseph, through his Shelter entities, had substantial dealings with Boston Financial, co-founded by Pratt. Boston Financial was sold to Lend Lease in 1999, with Pratt becoming a senior officer of Lend Lease. Pratt was terminated by Lend Lease in February 2003. The tax credit division of Lend Lease, comprised primarily of Boston Financial's business and currently referred to as Lend Lease HCI, was sold to MMA in July 2003. Shortly thereafter, Pratt became a director of MMA. Pratt retains extensive real-estate partnership interests in Boston Financial-related entities. Joseph's extensive interest in Shelter entities' dealings with Boston Financial subsequently became relationships assumed by MMA. 8-K filed 7-18-03; 10-K filed 3/12/04; Def 14A filed 4/30/04.

- Provident Bankshares: Joseph and Lucas serve on the Board (Def 14A filed 7/19/06), along with Ward B. Coe, III (current managing partner of Whiteford Taylor in which Hillman served as prior managing partner); Provident Def14A filed 4/9/07. Former MMA board member Carl Stearn had served as Chair (Def 14A filed 4/1/02). Provident Bankshare has contributed funds to the Greater Baltimore Committee, Greater Baltimore Alliance and Center Stage.

- Mercantile Bankshares: Berndt and Brown serve on the Board (DEF 14A filed 7/19/06). Has contributed to Greater Baltimore Committee and Downtown Partnership (*see next*).

- Greater Baltimore Committee (GBC): Joseph, Brown serve on the Board (Def 14A filed

7/19/06) along with Hillman's wife. They previously served along with former MMA board members Stearn and William Jews (Def 14A filed 4/1/02). Has received contributions from Provident Bankshares, Mercantile Bancshares, Baltimore Development Corp. (Falcone serves on Board; Def 14A 7/19/06), Whiteford Taylor; Mercantile, and Legg Mason (where Mehlman is on board).

- Downtown Partnership: Berndt serves as a director along with Marilynn K. Duker (president of Shelter Development), Kevin G. Byrnes (of Provident Bankshare), Cecil Flamer (of Brown Capital Management, founded and owned by Brown), and Alexander T. Mason (Mercantile Bankshares). It receives money from Mercantile Bancshares and East Baltimore Development (in which Brown serves on the board) and includes as partner organizations Baltimore Development Corporation, East Baltimore Development, Inc., and Greater Baltimore Committee.

- National Multi-Housing Council (NMHC): Joseph and Falcone serve on its board (Def 14A filed 7/19/06), and previously served with Banks (Def 14A filed 4/12/01).

- Baltimore Community Foundation: Board of Trustees includes Arnold I. Richman (of the Shelter Group), Harry S. Johnson (of Whiteford Taylor), Stephon A. Jackson (of Brown Capital Management), and Brown (currently Trustee Emeritus) (Def 14A filed 7/19/06). Has received contributions from the Weinberg Foundation (Joseph serves as a trustee; Def 14A filed 7/19/06) and has contributed money to Center Stage and Turning the Corner Achievement Program (a grant program founded by Brown and his wife, Sylvia).

- Center Stage: Falcone's wife, Beth W. Falcone, and Brown's wife, C. Sylvia Brown, served on its Board of Trustees (Mrs. Brown is currently Emiritus Trustee as of 2006-2007). It receives contributions from MMA, Provident Bankshares, Baltimore Community Foundation, Baum, Berndt, Hillman, Joseph, and Brown.

- Greater Baltimore Alliance: Falcone serves on the Board (Def 14A filed 7/19/06). It receives contributions from Hillman and Provident Bankshares.

- Economic Alliance: Berndt serves on the Board (Def 14A filed 7/19/06). It receives contributions from MMA.

The relationships shared among Defendants resulted in past lucrative financial gain and represent ongoing opportunities and day-to-day interactions that are significant enough to each of the Defendants' own self-interests to discourage Defendants from creating strife among themselves that might be the necessary result of any *bona fide* consideration of demand. Plaintiff has pled facts, which taken as a whole, *see McCall*, 239 F.3d at 816-17, demonstrate that the set of mutually-beneficial relationships shared among the Director Defendants are more than sufficient to create a reasonable doubt that the Director Defendants lack the independence to consider a pre-suit demand solely on its merits and without undue influence by extraneous considerations related to their intertwining relationships, or the undue influence, control or domination by Joseph, Falcone, or their fellow Board members. Accordingly, the Director Defendants cannot be considered independent for purposes of the Court's demand futility analysis.

2. Defendants Are Interested Because They Are Exposed to Personal Liability

The facts alleged by Plaintiff sufficiently raise a reasonable doubt that the Director Defendants can objectively consider a demand because each is exposed to personal liability arising out of the acts Plaintiff complains of. A director is interested, and unable to objectively consider a demand, where there exists a "substantial likelihood" of liability for the director if the corporate claims are prosecuted. *Ryan,* 918 A.2d 341, at 355.

A director's liability for breaching his or her duty of good faith "can be established by showing a sustained or systematic failure to exercise oversight," *Oxford Health Plans*, 192 F.R.D. at 117, or showing an extreme indifference or failure to act. *In re Caremark Int'l Inc., Deriv. Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996); *In re Walt Disney Co. Deriv. Litig.,* 906 A.2d 27, 67 n.110 (Del. 2006). In addition, Defendants' dissemination of false and misleading financial statements "cannot be deemed to be the product of a valid exercise of business judgment," and "[t]o the extent that a Defendant violated his or her fiduciary duty by allowing others to make materially false or misleading statements about [a corporation's] financial matters . . . demand is excused." *Oxford Health Plans*, 192 F.R.D. at 117. Thus, plaintiff can demonstrate demand futility by alleging "facts indicating that [ ] directors had actual knowledge of accounting irregularities, or knowledge of facts indicating potential accounting irregularities, and took no action until confronted." *Ash v. McCall*, No. 17132, 2000 WL 1370341, at *16 (Del. Ch. Sept. 15, 2000). A "fairly pleaded claim of . . .bad faith raises essentially a question of fact that cannot be resolved on the pleadings without first granting an adequate opportunity for discovery." *Desert Equities v. Morgan Stanley,* 624 A.2d 1199, 1208 (Del. 1993).

Plaintiff alleges that Defendants had actual knowledge of the accounting manipulation and improper transactions complained of, or failed to discover such as a result of their systematic failure to exercise oversight despite numerous red flags, thereby enabling the misconduct and permitting MMA to issue materially false and misleading statements concerning its financial matters. ¶¶29-30,47,56, 76-82, 103-106, 111. Through the Company's approval process for all related party transactions and the existence of numerous "red flags," Defendants were aware of facts indicating potential accounting irregularities. ¶¶44-48,51-58,68,70-74,92-102,111. Indeed, year after year until Defendants' accounting misrepresentations could no longer be sustained, the various actions alleged herein were used to manipulate the Company's reported financial results. *Id*. While the entire Board was apprised of virtually all alleged actions and inactions because of their related party nature, the Audit Committee also was apprised of failures to take other-than-temporary impairment charges on non-related party transactions and assets as well as the gross accounting incompetence and mismanagement. ¶¶58, 60, 68,161,165-166. At various times, all but two (McGregor and Lucas) of the Defendants have been on the Audit Committee. ¶¶4-13.

As a result of Defendants' misconduct and failure to exercise oversight, the Company has: (i) expended considerable resources in connection with an SEC investigation, NYSE review, and what will be a 21-month restatement process; (ii) restated its earnings no less than three times; (iii) lost access to important sources of capital and been forced to obtain capital at higher costs; (iv) been exposed to significant tax liabilities; (v) been exposed to securities lawsuits; and (vi) suffered waste of corporate assets.

Courts have found demand is futile under substantially similar factual circumstances. In

McCall, the Plaintiff pleaded that the directors consciously disregarded a number of "red flags" that would have alerted them to the fraud. The *McCall* court held that the HCA directors' failure to take action when presented with such obvious warning signs of fraud presented a substantial likelihood of director liability for intentional breach of their duty of care, creating a reasonable doubt as to their disinterestedness and thus rendering demand futile. *McCall,* 239 F.3d, at 824. In *Veeco,* the Plaintiffs contended that the Audit Committee failed to implement a reporting system or a system of corporate checks and balances designed to safeguard the company from financial fraud and a majority of directors breached their duty by ignoring red flags signaling the company's inadequate system of internal controls. *Veeco,* 434 F.Supp. 2d at 276-277 The *Veeco* court found that the allegations that defendants recklessly ignored such red flags of accounting impropriety yet approved financial statements using the flawed methods was more than sufficient to deny dismissal. *Id*, at 278. In *Abbott Labs.*, demand was found futile where plaintiffs alleged facts showing that the board consciously disregarded signs of non-compliance with Food and Drug Administration standards which led to company liabilities. Finding that the board knew or should have known of the non-compliance because they signed "SEC forms, which specifically address[ed]" such compliance, the court found the board was exposed to liability because their "decision to not act was not made in good faith and was contrary to the best interests of the company." *In re. Abbott Labs. Deriv. S'holders Litig.*, 325 F.3d 795, 808-09 (7th Cir. 2003).

Plaintiff has pled particularized facts sufficient to establish Defendants' potential liability for acting with extreme indifference in exercising their oversight duties or failing to take corrective action in the face of red flags, ¶¶24-159, including but not limited to:

> The timing of foreclosure/resale transactions of non-performing assets with related parties that served to smooth and inflate earnings, ¶¶110-132;
>
> The issuance of dividends unsupported by actual operating cash flow and despite the poor performance of a material amount of the Company's assets, ¶¶26-31;

> The maintenance of under-performing assets held by related-parties despite deteriorating performance and market conditions, precluding redeployment of corporate assets, ¶¶40-43,45-46;
>
> The Company's payment of charitable contributions to borrowers in order to keep loans of the Company in current status, ¶¶47-56;
>
> The repeated transfers by deed in lieu of foreclosure transactions from one Joseph-controlled entity to another accompanied by the Company's obligation to make delinquent debt service payments, ¶135;
>
> The routine positive statements issued concerning the Company's performance despite the severe issues with its portfolio of loans, ¶¶25,76-81,104;
>
> The failure to properly value non-performing assets pursuant to the Company's own valuation policies as well as accounting guidelines, including insisting on the Company's ability and intent to hold assets when the Company had, in fact, relinquished both ability and intent through its syndications, ¶¶57-75,93-103;
>
> The results from the MMA Portfolio Offering, the subsequent cancellation, and the failure to disclose this material information to shareholders which indicated the Company was significantly over valuing a material portion of its assets, ¶¶85-92;
>
> The Company failing to establish and enforce adequate accounting controls and procedures that have resulted in serial restatements, investigations and review by the SEC and NYSE, with the Company having to halt substantial business operations and lose access to important sources of capital, ¶¶82-84,147-155;

See also ¶161. The Audit Committee was responsible for ensuring the integrity of the Company's financial reporting process and systems of internal controls which required that they meet with management and the Company's auditors to review the Company's accounting practices. ¶165. These members endorsed financial statements by the Company affirming that they had reviewed and approved the financial statements affirming, and attesting to, the integrity of the accounting practices, ¶56, despite their knowledge of, or reckless disregard of, the improper accounting practices or accounting controls. As the knowledge of the Audit Committee "would have been shared at board meetings" with the rest of the board, *Abbott Labs.*, 325 F.3d at 806, "[u]nder proper corporate governance procedures," the full board is accountable for having knowledge of the improper accounting practices and inadequate internal controls. In addition, as numerous red flags concerning improper accounting treatments arose from related party transactions, such as the use of charitable contributions and the improper asset transaction to inflate earnings, all of the outside directors would have had notice of the improper treatment of those assets and the impropriety of the transactions since related party transactions had to be approved by a majority of the independent directors. In addition, the sheer magnitude of the deterioration to assets that were of key importance to the Company necessitates that the directors had knowledge of the issues surrounding the handling of the portfolio and the numerous red flags giving notice of improper treatment. *See*, *e.g.*, *In re Electronic Data Systesm Corp. Sec. and Erisa Litig*., 298 F.Supp. 2d 544, 557 (E.D. Tex. 2004) (the magnitude and importance of a key asset to the company creates an inference of knowledge concerning its status).[18] Despite the knowledge that the Company had engaged in accounting practices that violated GAAP and its own internal policies, each Director signed off on the Company's numerous financial reports. *Fina v. Calarco*, No. 01-030180263S, 2005 WL 3112894, at *7 (Conn. Super. Sept. 16, 2005) (applying Delaware law) ("Surely the conscious decision to sign off on forms required to be filed with [the SEC] was intended as a 'vouching' for the accuracy and integrity of the information there provided . . . .").

Demand is futile at least as to those ***five directors*** who were on the Audit Committee during the relevant period (Baum, Pratt, Mehlman, Hillman and Brown). Moreover, demand is futile as to Joseph and Falcone as officers who were informed and implemented the improper

[18] Plaintiff alleges that the Audit Committee and the rest of the Board were made aware of and deliberately chose to ignore the obvious red flags of accounting improprieties, thereby creating a disqualifying interest for demand purposes through their exposure to substantial likelihood of liability Defendants rely on *Rattner v. Bidzos*, 2003 WL 22284323 (Del. Ch. 2003), to suggest red flags are insufficient to create liability is unavailing. In *Rattner*, the plaintiff's "red flag" allegation consisted of a single financial statistic. *Rattner, 2003 WL 22284323 at *13*. The *Rattner* court found this red flag was insufficient to "demonstrate or permit [the Court] to draw the reasonable inference that the Director Defendants were aware of the possibly onerous elevation in a single financial statistic." *Id*. Here, unlike *Rattner,* Plaintiff has pled with particularity the existence of both actual knowledge and of numerous "obvious red flags [that would be] visible to the careful observer." which are sufficient to excuse demand under *Caremark. Id.*

accounting practices, and each of the outside directors who necessarily took action through their affirmative authorization of the transactions, because each had actual knowledge of, or recklessly disregarded, the accounting irregularities, or the systematic, improper accounting practices, of MMA. Accordingly, all of the Defendants are directly involved in the core allegations of the Complaint and eight out of ten Defendants are directly involved in those allegations relating to accounting control and mismanagement. With knowledge of the accounting improprieties and authorization of transactions in furtherance of such manipulation, all of the Director Defendants are subject to a substantial likelihood of liability "for the breach of the duty to exercise the appropriate attention to potentially illegal corporate activities." *Abbott Labs.*, 325 F.3d at 808.

Additional facts reinforce Plaintiff's particularized allegations that Defendants' "decision to not act was not made in good faith and was contrary to the best interests of the company," including: (i) continually increasing dividends despite the dismal performance of the Company's loan portfolio and its operating cash flow being insufficient for most quarters; (ii) the expected effects of interest rates at near-record lows; and (iii) scandals breaking in the sub-prime single-family residential field where there were similar situations involving high leverage loans being made to non-credit worthy borrowers. As discussed herein, where the plaintiff has alleged bad faith, as is the case here, questions of fact exist that cannot be resolved on the pleadings.

Defendants erroneously suggest that Plaintiff's references in its Complaint of the Company's stated internal controls, policies and the presence of its Audit Committee and its duties somehow absolve them of any responsibility regarding the numerous red flags, undermine Plaintiff's pleadings concerning the systematic failure of oversight by the Board, and evidence due care. Defs. Br. at 32-34. This is fallacious, and similar arguments are routinely rejected. *See Veeco*, 434 F.Supp.2d at 278, quoting *David B. Shaev Profit Sharing Account v. Armstrong*, 2006 WL 391931, at *5 (Del. Ch. Feb. 13, 2006) (Court observed that if plaintiff had alleged that the board had notice of misconduct and failed to investigate, such allegations would survive "even if the committee was well constituted and otherwise functioning."). The mere existence of purported internal procedures and controls does not presume enforcement thereof. Instead, Plaintiff cites MMA's purported policies to establish conscious and reckless disregard by the Audit Committee members of Defendants' wrongful actions and inactions. The Complaint is replete with allegations that the purported policies were ignored and contravened by Defendants. ¶¶58,60,68,161,165-166. Defendants' position is merely a testament to the adroitness of the ongoing misrepresentations, its suspect actions to keep the improper conduct from shareholders, and the unwillingness of the Board to take corrective action.

Defendants' position lacks merit. It requires the Court to draw inferences from the Complaint ***against*** Plaintiff and resolve questions of disputed fact in favor of Defendants, contrary to two well-settled practices. *Ryan*, 918 A.2d, at 375 (court must draw all reasonable inferences in favor of the non-moving party); *Krasner v. Moffett*, 826 A.2d 277, 284 (Del. 2003); *U.S. Bank Nat. Ass'n v. U.S. Timberlands Klamath Falls, L.L.C.*, 864 A.2d 930, 948 (Del. Ch. 2004) (disputed facts are not subject to resolution on a motion to dismiss). For purposes of resolving this motion, to the extent the Court might find Plaintiff has not pled explicit knowledge, the inference to be drawn from the Complaint is that Defendants knew about and failed to take corrective actions concerning the improper accounting practices and transactions, in violation of their fiduciary duties, and despite Company policy.

II. Plaintiff Has Adequately Pled The Derivative Claims

A. Pleading Standard Applicable to the Causes of Action

Unlike the particularity requirement for demand futility under Chancery Rule 23.1, notice pleading is all that is required to overcome a motion to dismiss under Rule 12(b)(6). *Solomon v. Pathe Commc'ns Corp,* 672 A.2d 35, 39 (Del. 1996). On a Rule 12(b)(6) motion, the complaint's allegations must be accepted as true and construed in a light most favorable to the plaintiff. *In re Symbol Technol. Secs. Litig.*, 762 F.Supp. 510, 516-517, (E.D.N.Y. 1991). Dismissal under Rule 12(b)(6) should not be granted "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitled him to relief." *McCall*, 239 F.3d at 815; *Ryan*, 918 A.2d at 357 (Del. 2007) (dismissal inappropriate "unless plaintiff would not be entitled to recover under any reasonably conceivable set of circumstances susceptible of proof.") Where demand futility is sufficiently pled, Courts have overwhelmingly held that a motion to dismiss under Rule 12(b)(6) should not be granted. *McCall*, 239 F.3d, at 815. The allegations pled in the Complaint concerning both demand futility and each of the causes of action are more than legally sufficient to withstand this motion.

B. Plaintiff Has Adequately Pled Breaches of Fiduciary Duty

To adequately plead a cause of action for breach of fiduciary duty, Plaintiff must only allege that: (1) a fiduciary duty exists; and (2) a fiduciary breached that duty. *York Linings v. Roach*, No. 16622-NC, 1999 WL 608850, at *2 (Del. Ch. July 28, 1999). Plaintiff need not allege specific harm. *Cede & Co. v. Technicolor*, 634 A.2d 345, 317 (Del. 1993).

1. Plaintiff Has Sufficiently Alleged that Defendants Owed a Fiduciary Duty to Municipal Mortgage

It is well established that officers and directors of a Delaware corporation owe a fiduciary duties to the corporation and its shareholders; the fiduciary obligation has been characterized as a "triad": due care, good faith and loyalty. *Jackson Nat. Life Ins. Co. v. Kennedy,* 741 A.2d 377, 386 (Del.Ch. 1999). A fiduciary must not seek to obtain any advantage over his principal, *Oberly v.* Kirby, 592 A.2d 445, 463 (Del. 1991) and must observe these duties when communicating with shareholders. *Jackson Nat. Life Ins. Co., 741 A2d at 389.* Plaintiff has sufficiently alleged that all Defendants are/were officers and/or directors of Municipal Mortgage, and that each owed a fiduciary duty to the Company. *See* ¶¶3-14, 19.

2. Plaintiff Has Sufficiently Alleged Defendants' Liability and Fiduciary Breaches Under *Caremark*

Defendants assert that Plaintiff's rely, unsuccessfully, on asserting that Defendants' liability is based upon a *Caremark* claim to excuse demand. Defendants mischaracterize Plaintiff's claim. Even if Plaintiff rested Defendants' liability upon the "unconsidered failure of the board to act in circumstances in which due attention would, arguably, have prevented the loss," *Caremark*, 698 A.2d at 967, to excuse demand, Plaintiff has sufficiently pled *Caremark* "oversight liability." In establishing liability under *Caremark*, a plaintiff must show "that directors knew or should have known that violations of law were occurring and, in either event, that the directors took no steps in a good faith effort to prevent or remedy the situation and that such failure proximately resulted in the losses complained of." *Id.* at 971; *Veeco*, 434 F.Supp. 2d at 276. "Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith" and are therefore liable under *Caremark*. *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006). Conscious disregard is found where the directors disregarded known risks, including "red flags," leading the Company and/or shareholders to suffer damages. *McCall v. Scott,* 250 F.3d 997, 1001 (6th Cir. 2001); *Veeco,* 434 F.Supp.2d at 276. "Unconsidered inaction can be the basis for director liability" under *Caremark* and Plaintiff need not show that a director intentionally acted to harm the corporation. *McCall*, 239 F.3d at 817-18. Plaintiff has sufficiently pled that (a) the directors failed to implement any reporting or information system or controls; or (b) consciously failed to monitor or oversee the implemented system or controls thereby disabling themselves from being informed of risks or problems requiring their attention. *Stone*, 911 A.3d at 370. As here, "where liability is based upon a failure to supervise and monitor, and to keep adequate supervisory controls in place, demand futility is ordinarily found, especially where the failure involves a scheme of significant magnitude and duration which went undiscovered by the directors." *Oxford Health Plans*, 192 F.R.D. at 117; *see generally McCall*, 239 F.3d 808; *Abbott Labs.*, 325 F.3d at 808.

Plaintiff has sufficiently pled that Defendants either knew, or should have known, that violations of the law were occurring and took no steps in a good faith effort to prevent or remedy the situation. All Defendants claimed by the Company to be independent and disinterested, including the members of the Audit Committee (Hillman, Mehlman (deemed the accounting expert), Brown, Pratt and Baum) and McGregor and Lucas, were aware of the violations because each authorized myriad insider transactions that involved outrageous foreclosures and immediate resale of property for the purposes of earnings smoothing, and the round tripping of charitable contributions to prop up otherwise defaulting bonds and maintain capital appreciation opportunities for Defendants Falcone and Joseph. ¶¶85-134, ¶¶47-56. Certainly, the Audit Committee members were aware of the misconduct through their role on the Audit Committee. As described in its charter, the Audit Committee's primary duties and responsibilities are to monitor: (a) the integrity of MMA's financial reporting process and internal controls; (b) MMA's compliance with legal and regulatory requirements; and (c) the independence, qualifications and performance of MMA's independent public accountants and internal audit function. ¶165. Through their affirmative actions and roles on the Board, Defendants were presented with myriad red flags about the dismal, deteriorating condition of the Company's loan portfolio and, rather than take necessary actions to maintain the integrity of the Company's financial statements and its ability to operate, the Directors engaged in acts which caused the Company to misrepresent its financial position. ¶¶24, 40-46, 72-73, 75, 86-91. These acts included canceling the MMA Portfolio offering, ¶¶86-92, due to low bids (while failing to inform shareholders of material facts learned from the offering), ¶¶88, 93, 107, and violating accounting standards and MMA's internal policies in valuing the tax-exempt debt assets, ¶¶57-

75, 93-109, despite the red flags and warning indicators of severe deterioration requiring revaluation, ¶46 (severity of amount in default and lost income), ¶45 (length of time in default and trend of increased defaults and lost income), among others. ¶¶47-56, 110-132, 135. These obvious warning indicators, among others, *supra,* would have alerted any fiduciary standing in Defendants' shoes to the lack of integrity in MMA's financial reporting process, its flawed system of controls, as well as its lack of compliance with legal and regulatory requirements, thereby demanding a heightened state of oversight and review.

Further, Defendants were on notice of all aspects of the Company's transactional accounting, including its existing tax credit business, a business the Company had been involved in for many years but which increased drastically with the acquisition of the tax credit subsidiary of Lend Lease in 2003. ¶13. With this acquisition, the Company's commitment of resources to tax credits grew significantly: "We are one of the nation's largest syndicators of low income housing tax credits. As of December 31, 2005, we had over $6.8 billion of tax credit investments under management, representing 1,760 properties." 2005 10-K, filed with the SEC on 6/22/06

For 2005, 2004, and 2003, the Company's syndication revenue was $93 million, $82 million and $33 million, respectively. 2005 Annual Report. By comparison, MMA reported interest income on its bond and loan portfolio of $154 million, $133 million and $108 million for fiscal years 2005, 2004, and 2003, respectively. As the tax credit business' contribution to the Company's revenue grew, so too did the assumption of associated large potential liabilities:

> "Our Business—Our Tax Credit Equity Segment," we provide guarantees to investors in connection with certain of the tax credit equity funds that we sponsor. We could be required to advance funds under such guarantees to lower-tier partnerships to ensure that the investors do not lose their expected tax benefits, and, if the internal rate of return to investors falls below the guaranteed level, we would be required to make a payment so that the guaranteed rate of return will be achieved. Our maximum potential liability pursuant to those guarantees was $547.7 million as of December 31, 2005."

2005 10-K, filed with the SEC on 6/22/06. Defendants, already on notice of rampant, chronic accounting malfeasance, were obligated to ensure that the financial reporting process and system of internal controls applicable to the growing tax credit business were adequate and complied with legal and regulatory requirements to ensure the integrity of the Company's financial reporting. Instead, Defendants recklessly disregarded the oversight of all aspects of the Company's financial reporting process and its system of controls, including those relating to the tax credit business which would soon necessitate a series of serial restatements. On March 10, 2006, the Company issued the first of many pronouncements, ¶¶148, 152, 154, concerning an extensive and lengthy restatement process. ¶153. Plaintiff has detailed the early restatement announcements indicating extensive material weaknesses in MMA's internal controls and reporting processes in its Amended Complaint at ¶¶148-154. The continual restatement announcements each significantly underestimated the extent and scope of the restatement, the periods to be restated, and the length of time it expected the restatement to be filed evincing Defendants' grossly inadequate monitoring and understanding of the Company's dire financial position and reporting controls. In the belatedly filed 2005 Annual Report, the Company conceded that it had an ineffective control environment due, in part, to a failure to "maintain a sufficient complement of personnel with a level of accounting knowledge and experience" commensurate with its financial reporting requirements and business activities, "particularly as our business grew in diversity and complexity," and a failure to "maintain or disseminate accounting policy guidance with respect to certain areas . . . to enable existing personnel to adequately analyze related transactions and apply accounting policies that were in conformity with GAAP." ¶151. In the 2005 Annual Report it acknowledged seven key areas of material weakness. ¶151; 2005 Annual Report at pp. 52-56 (attached hereto as Ex.C). The Company's late-filed first quarter 2006 quarter report filed on August 1, 2006 would be the last financial report that would be filed by the Company until its expected restatement in November 2007.

¶154. On August 10, 2006, the Company would file a notification of inability to file its quarterly report for the second quarter wherein it disclosed that "many of the remediation measures began subsequent to June 30, 2006" and that the material weaknesses in the Company's internal control over financial reporting have not been remediated. *See* Ex. D The Company noted that, finally, in June 2006, it trained its tax credit equity syndication accounting team in aspects of key accounting figures for tax credit businesses, including the recognition of syndication fees, the predominant source of revenue and income in the tax credit business, and the appropriate accounting for impairments of investments in real estate partnerships, a key figure due to the extensive use of partnerships, and in July 2006, it first engaged consultants to assist in ***creating*** and disseminating clear accounting policies, particularly those related to the tax credit equity business On September 13, 2006, shortly after Plaintiff's complaint was filed, the Company announced that its financial results for 2003 through 2005 could not be relied upon and that further restatements were forthcoming ¶152. This served as a restatement of a restatement that it had just issued not three months prior, and would restate the 2005 financial report it had filed in June 2006. ¶152. SEC filings on October 26, 2006 and December 8, 2006 each disclosed additional material weaknesses. ¶153; Exs. E, F.

Given the extent and apparent disarray of the Company's internal control and operations, and Defendants' obvious failure to adequately monitor and oversee the Company, it was of no surprise that the SEC commenced an inquiry. In a January 31, 2007, press release with a headline highlighting the "40th Consecutive Increase in Quarterly Distribution" which provided "highlights" for 2006, the Company buried in the next-to-last paragraph of the lengthy press release that the SEC had "commenced a non-public, informal inquiry." ¶159, 172, 184. Attached as Ex. G. On May 4, 2007, after the filing of the Complaint and Defendants' Brief, the Company filed a notification of late filing of its 2006 Annual Report wherein the Company conceded misapplying generally accepted accounting principles and disclosed that it found yet more material weaknesses in its internal control since its December 8, 2006 Form 12b-25 filing, including ineffective policies and procedures affecting its accounting for accrued expenses, its contractual compliance, and its identification of entities requiring consolidation that would requiring consolidation of entities the Company previously had not due to its interpretations concerning relatedness and control. The Company also disclosed that it improperly expensed start-up costs in tax credit ventures and incorrectly classified costs of acquiring investments in partnerships developing affordable housing projects. Attached at Ex. H. The filing stated that the Company was giving itself until November 30, 2007 to file the 2006 Annual Report and 2003 through 2005 restatements. It was also disclosed that the restatement would also focus on MuniMae TE Bond Subsidiary, LLC, the subsidiary largely responsible for the tax-exempt debt activities. By November 2007, the Company will not have issued any financial report since August 1, 2006, a report containing financials later declared unreliable, and will have been experiencing a continual restatement process for ***21 months***. So extensive is the gap in timing of reliable disclosures that MMA's stock is subject to NYSE delisting. See Ex. B.

The extent and scope of the restatement, along with its 21-month duration, have caused substantial harm to the Company. The restatement has caused the Company to expend substantial resources toward additional legal, accounting, and consulting services due to the extent of disarray of the Company's controls and the duration of the restatement process. Even at the outset, when the Company suggested it was a limited restatement, it conceded it was expending "significant" resources in order to restate the past results. ¶150. The Company has further incurred substantial expenses as a result of the SEC investigation which has been ongoing since no later than January 2007. The Company has suffered substantial harm to its business and the ability to conduct its business as a result of the numerous questions surrounding the

Company's credit worthiness and its true financial performance caused by the slow leakage of information concerning the Company's inadequacies. The Company has been subjected to extensive decreases in outside financing that serves as its lifeline for carrying out its business operations, let alone growth. *Supra p.12;* ¶¶155 (withdrew $9.3 million equity offering and $431,736,750 debt offering; $130 million reduction in a U.S. Bank credit line; closure of a $176 million credit line; $150 million reduction in Bank of America credit line). Ultimately, the extensive disarray has caused the Company to halt key parts of its business. *Supra* at p. 25.

In considering the sufficiency of Plaintiff's pleading *Caremark* liability where directorial liability for corporate losses arises from a restatement necessitated by the directors' systematic failure to exercise oversight, *Veeco*, 434 F.Supp. 2d 267, is instructive. In *Veeco,* plaintiffs alleged that director defendants comprising the audit committee were not disinterested directors where they failed to ensure the adequacy of the internal reporting system to prevent material accounting improprieties including the ***failure to write down inventories***. *Id*. at 277. In holding that the audit committee members were subject to a substantial likelihood of liability under *Caremark*, the Court found that the directors "fostered an environment that permitted the Company to conceal a number of alleged accounting improprieties and issue a series of allegedly fraudulent financial reports." *Id.* In so holding, the Court considered the extent of the potential harm to the *Company* (jeopardized its operations), the severe delay in the audit committee's response to strengthen, or implement, internal controls of a newly acquired Company (company took over a year after acquisition to address deficiencies), and the Company's admission that "a deficiency existed in the internal control over financial reporting." *Id.* .at 277-78.

Similarly, in *McCall,* 239 F.3d 808, 250 F.3d 997, the court, applying Delaware law, held that the members of the board faced a substantial likelihood of liability under *Caremark* where members of the senior management of the corporation were alleged to have devised schemes to improperly increase revenue and profits and the Board failed to prevent the act, or take corrective action, despite clear red flags that should have alerted them to potentially illegal activities. *McCall,* 239 A.2d. at 814. The court held that *Caremark* liability can be found where harm is caused due to inattention to obvious danger signs of wrongdoing. *Id.* at 818; *McCall,* 250 A.2d. at 1001 ("intentional ignorance of and willful blindness to red flags signaling fraudulent practices" cannot have been undertaken in good faith"). The red flags included inconsistencies in internal figures versus those distributed outside the corporation and performance statistics that were outside industry norm, likely unachievable without questionable practices. *Id.* at 820-821.

As alleged throughout the Complaint, Defendants were aware of numerous statistics concerning the value of the Company's non-performing assets and the lack of effectiveness of its internal controls and accounting policies as reflected in the extreme volatility of static numbers in its financial reports and the deterioration of disclosures, as well as the direct knowledge the Board had through the authorization of related-party improper transactions which enabled the earnings manipulation and deception of shareholders, all of which was readily apparent to the Board for a significant period of time. *See id*. at 823 ("the magnitude and duration of the alleged wrongdoing is relevant in determining whether the failure of the directors to act constitutes a lack of good faith."). Despite the awareness of the red flags concerning the inadequate internal controls of the Company, and the extensive growth in the Company's tax-credit business, Defendants failed to implement anything remotely close to adequate for the accounting policies for the tax equity divisions until 2006 and failed to take any remedial action to ensure adequate policies and controls over the accounting in its tax-exempt debt business. Based upon the allegations that Defendants consciously ignored numerous red flags in regards to the deteriorating financial condition of the Company's asset portfolio, the continuing failure to remedy identified flaws in its recording systems, and in the face of authorizing the numerous challenged transactions which Plaintiff pleads with particularity, Plaintiff has not only met, but gone above and beyond in overcoming the burden of *Caremark.*

3. Plaintiff Has Sufficiently Alleged that Defendants Breached Their Fiduciary Duties to Municipal Mortgage

Plaintiff has sufficiently alleged, on the face of the Complaint or by reasonable inference, that Defendants breached their fiduciary duties of loyalty, care and good faith.

a. Breach of Duties of Loyalty and Good Faith[19]

Axiomatic to their duties, "[c]orporate officers and director are not permitted to use their position of trust and confidence to further their private interest" over that of the corporation they serve. *Guth v. Loft, Inc.,* 5 A.2d 503, 510 (Del. 1939*)*. The duty of loyalty requires that directors and officers ascertain that the "best interest of the corporation . . . take[s] precedence over any interest possessed by a director, officer . . . and not shared by the stockholders generally." *Cede & Co.*, 634 A.2d at 361. A breach of the duty of loyalty may be shown where the board acts intentionally, in bad faith, or for personal gain in connection with a challenged transaction. *Ryan, 918 A.2d* at 357. Bad faith may be shown where "the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of known duty to act, demonstrating a disregard for his duties." *Stone*, 911 A.2d at 369. The duty of good faith is breached where a director consciously disregards his duties to the corporation, thereby causing its stockholders to suffer. *McCall,* 250 F.3d at 1001. These duties extend to the corporate officers and directors communications with shareholders:

> Whenever directors communicate publicly or directly with shareholders about the corporation's affairs, with or without a request for shareholder action, directors have a fiduciary duty to shareholders to exercise due care, good faith and loyalty. It follows a fortiori that when directors communicate publicly or directly

[19] Plaintiff treats these two duties concurrently because the requirement to act in good faith "is a subsidiary element, i.e., a condition, of the fundamental duty of loyalty" and only the breach of duties of care or loyalty may directly result in liability. *Stone v. Ritter*, 911 A.2d at 370.

> with shareholders about corporate matters the *sine qua non* of directors' fiduciary duty to shareholders is honesty.
>
> * * *
>
> When the directors are . . . deliberately misinforming shareholders about the business of the corporation, either directly or by a public statement, there is a violation of fiduciary duty. That violation may result in a derivative claim on behalf of the corporation or a cause of action for damages.

Malone v. Brincat, 722 A.2d 5, 10-14 (Del. 1998); s*ee also Metro Commc'ns Corp. BVI v. Advanced Mobilecomm Techs., Inc.*, 854 A.2d 121, 153 (Del. Ch. 2004) (duty of loyalty breached when director learns prior communications to shareholders were false and intentionally remains silent); *O'Reilly v. Transworld HealthCare, Inc.*, 745 A.2d 902, 914-15 (Del. Ch. 1999) (duty of loyalty implicated facts pled to "support the inference that the disclosure violation was made in bad faith, knowingly or intentionally.").

Plaintiff alleges that Defendants knew of the accounting misrepresentations and manipulations yet permitted them to be publicly disseminated and acted in bad faith for their own personal interest or for the interest of those to whom they are beholden, as follows:

¶¶30-38 --Defendants increased dividends, despite inadequate cash flow from operations, in order to be able to continue to issue debt and equity and perpetuate Joseph's and Falcone's self-dealing;

¶46-60, 86-87, 95-105 -- Defendants caused the Company to improperly value MMA's non-performing assets in violation of accounting and SEC standards, and in contravention of MMA's internal policy, and, accordingly, issue false financial statements concerning the value and performance of those assets which was in striking contrast to reality and internal documents such as those issued in the MMA Portfolio Offering, in order to maintain confidence of the financial markets necessary for financing;

¶¶ 61-69 -- Defendants falsely represented the basis for not taking other-than-temporary impairment charges pursuant to clear accounting guidance because of an "intent and ability to hold" the assets despite the Company relinquishing both intent and ability through securitizing the assets and after the Company had put many of the assets up for sale;

¶¶47-56 -- Defendants caused the Company to waste corporate assets through charitable contributions in order to conceal the extent of loan deteriorations and to default-proof Joseph and Falcone's asset interests;

¶24 -- Defendants permitted and participated in false investor communications attesting to MMA's performance, and dividend increases, while knowing that the Company's true financial performance did not support the issuance of such dividends;

¶¶76-85 – Defendants permitted the Company to reduce the transparency of its accounting standards to prevent shareholders from gaining an accurate picture of the performance of the portfolio;

¶¶106-109 – Defendants exposed the Company to enhanced regulatory scrutiny causing Company to expend its resources to sustain non-performing assets so that Defendants can continue to personally benefit from inflated dividend and stock prices and personal control over assets made default proof through their control of MMA, while filing knowingly false Annual Reports for public consumption;

¶¶110-135 – Defendants caused the Company to execute numerous non *bona-fide* improper, related-party transactions in order to smooth and manipulate earnings, and consequently, make false financial statements;

¶¶136-146 – Defendants violated MMA policy and Internal Revenue Service regulations governing the tax treatment of MMA's tax-exempt debt, rendering hundreds of millions of dollars of tax-exempt proceeds taxable, exposing the Company to tax fraud charges and shareholders to additional tax liabilities, while issuing false statements regarding the debts' treatment and compliance; and,

¶¶147-159 – Defendants failed to properly institute, administer and maintain adequate accounting and reporting controls, resulting in MMA expending substantial resources in a massive restatement process, an SEC investigation and losing substantial access to financial markets necessary to operate its business and halting a substantial part of its business while conferring benefits based on the erroneous financials to Defendants, including performance based compensation.

Defendants attempt to shield themselves from liability by arguing that their actions are protected by the business judgment rule. The rule does not bestow absolute protection, *Aronson*, 473 A.2d 805, and is merely a limited affirmative defense allowing corporate fiduciaries that do not have conflicts between duty and self-interest and who maintained undivided loyalty to the corporation leeway to make normal business decisions. *Guth*, 5 A.2d at 510 (reiterating the duties of loyalty and good faith that a fiduciary is obligated to uphold). Absent unusual circumstances (not present here), the rule cannot serve as grounds for dismissal as a matter of law. *See In re Tower Air, Inc.*, 416 F.3d 229, 238 (3d Cir. 2005) (dismissal on 12(b)(6) motion generally not granted on grounds of an affirmative defense such as the "business judgment rule."). The proponent of a claim may rebut the business judgment rule by introducing evidence either of director self-interest or self-dealing, or that the directors either lacked good faith or failed to exercise due care, to demonstrate directors failed to act in the best interest of the Company and/or shareholders. *Smith v. Van Gorkom,* 488 A.2d 858, 872 (Del. 1985); *Cede & Co.*, 634 A.2d at 361; *see also In re GM (Hughes) S'holder Litig.*, No. 20269, 2005 WL 1089021, at *10 (Del. Ch. May 4, 2005) (where business judgment rule does not protect action, defendants must justify why they are not liable and it "is unlikely, if not impossible, for a defendant to meet this burden on a motion to dismiss"). Plaintiff has more than sufficiently alleged that Defendants have breached both their duties of loyalty and good faith. ¶¶30-38, 46-159. Thus, Defendants' motion to dismiss Plaintiffs duty of loyalty claims must be denied.

b. Breach of Duty of Care

Plaintiff alleges particularized facts demonstrating Defendants breached their duties of care (and good faith) to MMA by consciously failing to exercise sufficient oversight to prevent or correct the accounting manipulations, associated transactions, and misleading statements issued to investors. Defendants either had specific knowledge of the impropriety of the conduct as a result of their affirmative authorizations of the actions, or were on notice due to numerous red flags. Consequently, Plaintiff's due care claims are directed to the Defendants' "conscious disregard" of the problems facing the Company, *see Abbott Labs.*, 325 F.3d at 809, imputing liability for breaching their duty of due care and also duty of good faith. *In re Walt Disney Co. Deriv. Litig.*, 907 A.2d 693, 755 (Del. Ch. 2005) ("Deliberate indifference and inaction in the face of a duty to act is . . . conduct that is clearly disloyal to the corporation. It is the epitome of faithless conduct."), *aff'd*, 906 A.2d 27 (Del. 2006).

Defendants incorrectly characterize Plaintiff's claims as *Caremark* claims. This simplification ignores Plaintiff's factual recitations regarding systematic improprieties. The distinction between a *Caremark* claim and that which Plaintiff alleges is succinctly explained in *Abbott*, 325 F.3d at 806. In denying a motion to dismiss, the *Abbott* court found that "[p]laintiffs allege that the directors 'knowingly' in an 'intentional breach and/or reckless disregard' of their fiduciary duties "chose" not to address" the liability creating problems in.a timely manner. *Id.*. Such conscious and knowing disregard, and willful blindness to apparent red flags, if proven, "cannot have been undertaken in good faith" and gives rise to claims that "do not fit easily into the terminology of Delaware corporate law." *McCall*, 250 F.3d at 1000-1.

Plaintiff's claims reflect those in "*Abbott*" and "*McCall*". Plaintiff does not merely allege that Defendants were simply grossly negligent in failing to become aware of the alleged improprieties. Instead, Plaintiff alleges that Defendants knew of the misconduct itself (i.e. the related-party transactions and true state of the Company's finances as evidenced by the failed distressed portfolio sale) and/or the red flags regarding the prolonged and systematic failures of oversight, or recklessly disregarded multiple red flags indicating the improprieties. Defendants breached their fiduciary duties by taking no corrective action to address and correct the problems, but rather enabled the problems by specific approval of the transactions and authorization of false and misleading statements.

Defendants breached their fiduciary duty of care under *Abbott* through a cornucopia of actions that individually, and, collectively, through a pattern of conduct, gives rise to liability. Plaintiff alleges that the directors have "knowingly," in an "intentional breach and/or reckless disregard" of their fiduciary duties, "chosen" not to address the significant deteriorations in the carrying value of a material portion of the Company's tax-exempt portfolio, and, in fact, took additional steps to misrepresent such material facts to shareholders through an ongoing scheme of decreasing the transparency of its financial disclosures and omitting and misrepresenting material information. ¶¶23-24, 40-109. The tax-exempt debt portfolio was a material asset to the Company whose underlying performance and values was pertinent to shareholders and the financial markets. ¶¶23, 25, 33, 44, 79. Due to the significance and importance of the tax-exempt bond portfolio and its materiality to the Company's business, each of the Director Defendants, regardless of the additional committee positions each held with the Company, was fully aware of the extensive deterioration of the tax-exempt bond portfolio. This included the extensive and alarming decline in debt service for the assets securitizing the tax-exempt bonds, ¶¶42, 43, 46, 86-87; the alarmingly low level of debt service coverage of the underlying the assets, ¶¶42, 86-87; the high level of foreclosures of debt comprising the bond portfolio, ¶¶46, 161(c); the extensive duration of time the bonds remained in a loss position, ¶¶73, 86; and the high percentage (over one-third) of the combined face-value of loans in default or on non-accrual status. ¶¶24, 161(g).

Defendants were also aware of the growing lost income to the Company as a result of the bonds on non-accrual status, ¶¶45-46, 75, exclusive of the opportunity costs and ongoing deterioration in the assets caused by continued holding of the non-performing debt. ¶85. Against this backdrop of clear deterioration and non-performance, Defendants were aware of the insufficient and miniscule other-than-temporary impairments the Company had recorded, ¶¶46, 74, as well as the continued trend of deterioration. ¶¶42, 44. Despite their knowledge of the financial characteristics of the tax-exempt debt portfolio and the numerous red flags, Defendants consciously and recklessly disregarded these red flags and their fiduciary duties and chose not to provide proper accounting treatment to the deteriorating assets, failed to properly consider the handling of such assets, and provided false and misleading financial reports to investors.

While their fiduciary duties required Defendants to ensure the Company developed, implemented and maintained an effective system to value and monitor its assets, Defendants failed to take or implement even remedial steps to value these assets despite their knowledge and/or existence of clear red flags. ¶¶59-60. In fact, in further breach of their fiduciary duties of due care, loyalty, and good faith, Defendants authorized affirmative actions to obfuscate the extent of the deterioration in the tax-exempt bond assets by authorizing MMA to make charitable contributions to both related and unrelated parties for use by the recipients to make interest payments to the Company, thereby artificially lowering the number of bonds that belonged on non-accrual status, ¶¶47-56, and systematically reducing the transparency of the Company's financial disclosures decreasing the ability of financial market participants to glean material information concerning the Company's financial condition. ¶¶76-84. In contravention of the Company's self-stated internal policies, ¶¶58-60, 62-64, 69, 92-93, 98-100, and clear accounting directives, ¶¶61-68, 92-97, 101, 103, Defendants failed to properly value the Company's non-performing tax-exempt debt assets and directed and authorized the Company to prepare and issue financial statements that were in violation of GAAP and other accounting guidance concerning the recording of other-than-temporary impairment. ¶¶46, 57, 64, 70-71, 85, 100-109.

Demonstrating further conscious disregard of the red flags, the Directors caused the Company to continually issue dividends unsupported by MMA's operating cash flow and actual performance or taking into consideration the true value of the tax-exempt bonds and declining financial outlook. ¶¶26-39. Contemporaneously, Defendants authorized the Company to engage in a set of improper asset transactions which artificially inflated its financial performance, served to improperly smooth earnings to justify that the dividend issuances were supported by MMA's performance, and served to misrepresent the status of the substantially deteriorated tax-exempt debt portfolio and the ability of the Company to manage such assets. ¶¶110-135. The jettisoning of MMA's actual performance through the amalgam of improper acts was done with conscious disregard by Defendants of the proper treatment of these assets necessary to maintain their tax-exempt nature. ¶¶136-146. By breaching their duty of care to properly treat the tax-exempt assets, in part as a consequence of their haste to compensate for the deterioration of the debt and maintain the confidence of the financial markets, Defendants caused further harm to shareholders and the Company by exposing both to tax fraud charges and extensive tax amendment processes as a result of hundreds of millions of dollars of tax-exempt proceeds being deemed taxable as a result of Defendants improper treatment. ¶¶144-146.

The internal chaos reflecting the inadequate internal controls and Defendants' intentional disregard and circumvention of any such controls and policies, concerning the Company's treatment of its tax-exempt debt, not surprisingly, spread to the Company's tax-credit business, a division that Defendants knew was becoming an integral part of the Company's growth and which compensated for the Company's poorly performing tax-exempt debt business, ¶¶42, 151-153, leading to the significant restatement process as discussed herein.

Defendants, in fact, do not deny that they were aware of the extensive portfolio deterioration. As alleged and otherwise clear from the extent of problems and the importance of the assets affected, the Defendants were aware of the deterioration and status of the assets. Defendants' affirmative and improper, actions to compensate for the problems, including their authorization of improper asset transactions, charitable contributions and decreased disclosure transparency, further substantiates Defendants' knowledge of the accounting problems pervasive throughout the Company, as evidenced by the Company's current extensive restatement.

Defendants attempt to raise the factual argument that they relied on outside experts, including their accountants, and that such reliance absolves them of liability, disregarding that much of the alleged improper conduct lies outside the purview of experts. This is not supported by the facts or their own pleadings.[20] Ultimately, this defense raises a question of fact (i.e., were accountants apprised of all material facts?; did Defendants respond appropriately to expert

[20] For example, MMA's policy on asset valuation does not rely on outside experts. ¶¶59, 89, 98-100.

advice?), not appropriately considered on a 12(b)(6) motion to dismiss. *Info. Handling Servs. v. Def. Automated Printing Servs.*, 338 F.3d 1024, 1036 (D.C. Cir. 2003) (questions of material fact cannot be resolved on a motion to dismiss); *Suarez Corp. Indus. v. McGraw*, 125 F.3d 222, 229 (4th Cir. 1997) (affirmative defenses should not be considered on 12(b)(6) motion unless the defense "clearly appears on the face of the complaint."). In addition, as fiduciaries of the Company, Defendants cannot blindly rely on outside experts, and certainly do not make themselves immune by doing so. ¶165 (principal duties of the Audit Committee). Directors do not and cannot just operate within the vacuum of information provided to them by outside consultants or experts. *See Cede & Co.*, 634 A.2d at 367 (duty of due care requires directors to adequately inform themselves of all material information reasonably available to them, and then must act with requisite care in the discharge of their duties). Five of the Director Defendants made up the Audit Committee, though Plaintiff would argue that all the Director Defendants were privy to the knowledge of the Audit Committee which would have been shared "under proper corporate governance procedures," *Abbott Labs*, 325 F.3d at 806. In addition, the Director Defendants knew or were reckless in not knowing of the deteriorating tax-exempt debt portfolio, ¶44, the charitable contributions, ¶¶48, 56, and the improper transactions, ¶¶116-117, 135, since they either authorized those corporate acts or executed the Company's numerous financial reports containing such information. As a result, they were required to act on the information obtained by, and provided to, them and to decide independently how to protect the best interests of the Company and its shareholders. ¶¶16, 58; s*ee Van Gorkom*, 488 A.2d at 873 (directors have a duty to act in an informed and deliberate manner, and once reasonably informed must act with requisite care in discharge of duties rather than abdicating duty to others).

Plaintiffs has sufficiently alleged that the Directors have breached their fiduciary duties by intentionally failing to act in the face of a known duty to act, demonstrating a conscious disregard for their duties, *Stone,* 911 A.2d at 369; *Abbott Labs,* 325 F.3d at 808. Defendants cannot shield themselves from liability by delegating away their duties to, or on the reliance of, others. Ultimately, such a question of fact concerning purported reliance cannot be considered at this stage to be dispositive of Plaintiff's claims.

4. Plaintiff Has Adequately Stated a Claim for Unjust Enrichment

A defendant is liable for unjust enrichment if he receives a benefit to the loss of another. *Jackson Nat. Life Ins. Co.*, 741 A.2d at 393 (unjust enrichment is defined as "the unjust retention of a benefit to the loss of another . . .against the fundamental principles of justice or equity and good conscience."). The elements of unjust enrichment are: (1) an enrichment; (2) an impoverishment; (3) a relation between the enrichment and impoverishment; (4) the absence of justification; and (5) the absence of a remedy at law. *Id.*

Certain of the Defendants were unjustly enriched through numerous transactions authorized by the Director Defendants at the Company's expense. ¶¶47-56 (charitable contributions), ¶¶110, 118-135 (maintenance by MMA of non-performing assets and MMA's assumption of liability of deterioriated assets for the benefit of insiders); ¶¶156, 167 (compensation tied to artificially inflated financial performance); and ¶¶51, 53, 54, 55, 56, 102, 135, 161s(i-v) (transfer of corporate opportunities and assumption of certain of Defendants' personal liabilities). Plaintiff sufficiently pleads a claim for unjust enrichment against all Defendant Directors as a result of their authorizing and obtaining a compensation scheme tied to the fraudulently-reported financial performance of the Company. ¶¶ 32-33, 103, 156, 167-169. *See In re HealthSouth Corp. S'holder Litig.*, 845 A.2d 1096, 1105-06 (Del. Ch. 2003) (summary judgment for plaintiff on unjust enrichment claim where company retired debt obligations of CEO by buying back from CEO company stock whose market price was inflated by false financial statements he signed).

Defendants, in violation of their fiduciary duties, took affirmative actions in furtherance of a scheme to deceive shareholders regarding the true financial performance of the Company by causing the Company to file unreliable financial reports that overstated the financial performance of the Company. ¶¶25, 46-47, 51, 57, 70-71, 101-103, 106-109, 110. Throughout this period of misrepresentations, the Director Defendants, including Defendant Hillman, Baum, McGregor and Lucas, created, authorized and implemented compensation and benefit policies for key officers that relied upon published performance measures which they knew were not indicative of MMA's true financial performance, resulting in MMA issuing excessive compensation to the executives, including Joseph and Falcone, to the detriment of the Company. ¶166-167, 169. The Defendant Directors authorized the excessive issuance of dividends at the expense of the Company, which incurred additional liability to permit the dividend distributions, and which permitted each of the Defendant Directors to monetize the value of their services on the board and the options/stock that each held in connection with their positions. ¶¶32-33. The benefits to the Defendants from these transactions and the accompanying accounting manipulation came at the impoverishment of MMA, including: (a) increased liabilities to facilitate the payment of the dividends; (b) increased liabilities caused by assuming and maintaining non-performing assets at the direction of the Defendants, ¶135; (c) expenditure of significant resources on the restatement process and SEC investigation caused by the deterioration in, and inadequacy of, MMA's internal controls; (d) lost opportunities caused by the halt in certain of its key businesses caused by its failure to have accurate and timely reports due to the restatement; (e) reductions in its access to external capital,*;* (f) exposing MMA to significant potential liability for violations of the federal securities laws[21]; and (g) suffering irreparable damage to its credibility and business reputation. Plaintiff further alleges that the Director Defendants continue to economically

[21] The conduct alleged herein violates federal securities laws. *See, e.g.*, *In re Unumprovident Corp. Secs. Litig.*, 396 F.Supp. 2d 858, 890-892 (E.D. Tenn. 2005) (claims of misrepresenting asset values through the failure to take other-than-temporary impairment give rise to liability under federal securities laws).

benefit through their service agreements with the Company that rely on the ongoing accounting manipulation and have continued to do so as a result of the extensive duration of the Company's restatement. ¶¶103-107. The undeserved benefits received by each of the Defendants to the impoverishment of MMA to obtain such benefits is unjust.

Defendant Joseph and Falcone were further unjustly enriched through the Defendants authorization of "charitable contributions" from MMA which included significant amounts of cash and property to non-profit entities in which Joseph and/or Falcone had interests. ¶¶53, 55. By utilizing the "charitable contributions" to subsidize debt service of non-performing assets owned by related-party entities of Joseph and Falcone back to the Company, Defendants were allowing otherwise non-performing loans to be maintained in non-default status, thereby keeping the assets under their personal control in order to obtain any capital improvements to such assets at MMA's expense and risk, and rendering these assets default-proof. ¶¶54, 56, 161(i), 161(q), 161(s), *supra*. The Board had full knowledge of the "charitable contributions" because of the Board's required approval of all transactions that involved related parties. ¶56, *supra*.

Defendants also authorized numerous deed in lieu of foreclosure transfers from the original borrowing entity to the non-profit entities controlled by Joseph and/or Falcone, thereby transferring opportunities that belonged to the Company to Joseph and/or Falcone while the Company still maintained the entirety of the risk. These transferee entities included MMAHA, MuniMae Affordable Housing, Inc (MMAH) and The Shelter Group (an entity in which Defendant Joseph owns a 34.7% interest) to which the Company also acts as a tax credit syndicator and as to which it has extended a $1.5 million loan. ¶¶51, 53, 54, 55, 56, 102, 135, 161s(i-v). While certain of the Defendants benefited by the transactions that permitted them to hold onto non-performing assets for the potential personal capital gains, MMA was exposed to ever-larger losses, significant regulatory and civil liability, including tax liabilities, that could undermine the MMA's tax-exempt bond and tax-credit business. ¶110.

Plaintiff has also stated a sustainable claim for unjust enrichment in connection with certain Joseph and/or Falcone entities. For example, the Company assumed financial responsibility of their failed personal investment venture, Village of Stone Mountain. ¶135.

5. Plaintiff Has Adequately Pled Claims of Gross Mismanagement

Delaware courts have long recognized that stockholders are entitled to relief where there is "gross mismanagement on the part of board of directors or a reckless disregard on their part of their duties to the corporation and its stockholders." *Bodell v. General Gas & Electric Corp.*, 140 A. 264, 267 (Del. 1927); *Williams v. Don Yerkes Fine Cars,* No. 4777, 1977 WL 2582, at *4-5 (Del. Ch. June 1, 1977) (gross mismanagement found where, among other things, shareholder/officer caused corporation to take on extensive debt despite significant down-turn in business and financial operations resulting in over-leveraging of corporation and significantly greater losses due to corporation selling inventory purchased with debt at a loss).

Plaintiff's extensive allegations in the Complaint regarding (i) the control Defendants had over the Company; (ii) numerous improper acts bestowing unjustified benefits upon one another at the Company's expense; (iii), a pattern of bad-faith decisions that effectively siphoned off corporate assets to create, divert and maintain opportunities for certain of the Defendants; (iv) an inadequate internal accounting system which deteriorated and was circumvented by Defendants; (v) conduct that deceived MMA's creditors and shareholders; and (vi) improper treatment of tax-exempt assets giving rise to tax liabilities, are sufficient to plead a claim of gross mismanagement. *See, e.g.*, *In re PRS Insurance Group, Inc.*, 274 B.R. 381, 385, 387 (Bkrtcy. D. Del. 2001) (citations omitted) (diversion of funds and misuse of corporate assets sufficient to demonstrate gross mismanagement); *In re Cincinnati Bell Cellular Systems Co. v. Ameritech*, No. 13389, 1996 WL 506906, at *16 (Del. Ch. Sept. 3, 1996) ("A combination of negligent acts by the same person may constitute gross negligence when the negligent acts can be viewed as cumulative with causative factors or inextricably related events leading to a particular incident or injury."); *In re Sharon Steel Corp.*, 871 F.2d 1217 (3rd Cir. 1989) (gross mismanagement finding affirmed where company's working capital was left in shambles forcing the company to seek higher-interest working capital; debtors internal accounting system was so lacking that it was unable to accurately measures its financial condition; and asset transfers from the company were made to affiliates of insiders); *In re Colby Constr. Corp.*, 51 B.R. 113, 116 (Bankr. S.D.N.Y. 1985) (gross mismanagement where accounting system failed to reflect company's financial condition and the reporting system was in disarray). Defendants' conduct has resulted in massive, ongoing, financial damages including the curtailment of the Company's operations and damages to MMA's public reputation. Plaintiff's allegations are sufficient to support a cause of action for gross mismanagement for purposes of a Rule 12(b)(6) motion to dismiss.

6. Plaintiff Has Stated a Claim of Waste of Corporate Assets

"The essence of a claim of waste of corporate assets is the diversion of corporate assets for improper or unnecessary purposes. . . . It is common sense that a transfer for no consideration amounts to a gift or waste of corporate assets." *Michelson v. Duncan*, 407 A.2d 211, 217 (Del. 1979). "Waste" is defined as "'an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade.'" *Brehm v. Eisner*, 746 A.2d 244, 263 (Del. 2000). Plaintiff need only allege that the board '"irrationally squander[ed]' corporate assets – for example, where the challenged transaction served no corporate purpose or where the corporation received no consideration at all." *Id.* at 554. The consideration of a well-pleaded claim for corporate waste is "inherently factual and not easily amenable to determination on a motion to dismiss and indeed often not on a motion for summary judgment." *Lewis v Vogelstein*, 699 A.2d 327, 339 (Del. Ch. 1997). Moreover, where, as here, a plaintiff adequately pleads demand futility, the claims for corporate waste should be sustained on a motion to dismiss for failure to state a claim. *In re Walt Disney Co. Deriv. Litig.*, 825 A.2d 285 (Del. Ch. 2003).

Many of Defendants' acts alleged in the Complaint constituted corporate waste, serving no legitimate corporate purpose except to benefit certain of the Director Defendants or to further Defendants' ongoing scheme to manipulate MMA's earnings and accounting representations. ¶¶51, 53-56 (significant charitable contributions served to assist related parties in maintaining control of investments and misrepresenting extent of non-performance of portfolio); ¶135 (assumption of liabilities of $34 million failed personal venture); ¶161(s)(a)(iiii) (extension of $1.5 million revolving loan to Shelter Group); ¶161(s)(a)(iv) (transferring $175 million worth of defaulted assets to Joseph-controlled entities, including The Shelter Group, thereby transferring capital appreciation opportunities to those entities); ¶¶167-168 (granting of excessive compensation based on false financial reports).

Based on the foregoing, Plaintiff has pled facts sufficient to state a claim for waste under Rule 12(b)(6).

III. MMA's Articles of Incorporation Cannot Bar Plaintiff's Claim at this Stage of the Litigation

Defendants assert that the Director Defendants are immunized under MMA's Amended and Restated Certificate of Formation and Operating Agreement (the "Operating Agreement") (Defs. Br. at 26) and the LLCA's immunity providing protection to directors "who make decisions in reasonable reliance on the expertise of others." (Defs. Br. at 27). Defendants do, however, acknowledge that the Limited Liability Company "may not limit or eliminate a bad faith violation of the implied contractual covenant of good faith and fair dealing." (Defs. Br. at 27, quoting LLCA, §18-1101(e).

Contrary to Defendants' assertion, the Operating Agreement does not provide blanket immunity for Defendants' wrongdoing. As specifically quoted, the Operating Agreement provides that the immunity does not apply in the case of fraudulent or illegal conduct of any director or officer. Defendants take the position that the Complaint fails to allege with particularity that any of the director defendants knowingly engaged in conduct that was fraudulent or illegal, but their discourse conveniently ignores the "or illegal" language and instead focuses on the reference to "fraudulent" conduct.

The Complaint is replete with allegations that Defendants acted illegally in causing the Company to engage in certain transactions and in making material misrepresentations in the Company's SEC filings. In fact, Plaintiff specifically alleges that Defendants have acted illegally in several respects.

- The Director Defendants caused the Company to make substantial loans to 501(c)(3) borrowers to support defaulted payments (thereby concealing the Company's true state of finances) and to transfer MMA assets to Joseph-controlled entities. ¶¶47-53. Plaintiff does not allege that defendants were negligent in overseeing the work of the Company's accounting professionals in connection with the making of charitable contributions and the determination of impairment of capital. Instead, plaintiff alleges that the defendants took such actions to serve the interests of the Individual Defendants, in contravention of their duty of loyalty.

- The Director Defendants caused the Company to conceal the true extent of the impairment of its assets, and to disclose to bidders on its Distressed Portfolio information that had not been disclosed to its stockholders regarding the true state of the Company's finances. ¶¶86-88. As much as the Defendants may wish it were so, plaintiff does not allege that the Directors were negligent in making the representations (thereby meriting to their position of having relied in good faith on the Company's accounting professionals). Instead, plaintiff alleges defendants knew the true state of affairs but it was not until they had to disclose the information to prospective bidders that the true picture appeared. Even then, the information was provided to the prospective bidders under terms of confidentiality and defendants have continued to assert confidential protection for the information in this action, rather than to provide the same information to the Company's shareholders. Indeed, the Company's SEC filings continue to misrepresent the Company's true financial condition. ¶¶102-105, 107.

- Plaintiff details at least three illusory transactions which Defendants caused the

> Company to execute for the purpose of inflating the Company's earnings to maintain the facade concerning the underlying strength of its tax-exempt bond portfolio and its purported abilities to recapture complete value on non-performing assets, and alleges that Defendants actively implemented and authorized each of these transactions in contravention of their duties to the Company and its shareholders in order to maintain control over the assets that would personally benefit each of them. ¶¶113, 114.

Notwithstanding Defendants' assertion that the Complaint does not state the Board's involvement in the Company's financial recording and reporting systems, the Complaint contains specific allegation in this regard at ¶161(s)(a)(v) (the disinterested members of the Board approved transactions between the Company and the Joseph-controlled Shelter Group; ¶165 (the purported responsibilities of the Audit Committee, and the failure of its members, Defendants Baum, Brown, Hillman, Mehlman, and Pratt, in their duties); and ¶167 (the purported responsibilities of the Compensation Committee, and the failure of its members, Defendants Hillman, Baum, McGregor and Lucas, to implement and enforce policies to ensure that the performance-based compensation paid to certain of the Individual Defendants, was in fact based on the true financial performance of the Company). Finally, plaintiff asserts that the Defendants "have actively condoned and facilitated a campaign of deceit upon the shareholders of the Company through the Company's filings with the SEC, communications with the public, and the Board's authorization of dividend increases. The Director Defendants approved option compensation, approved officers' incentive compensation, and received their own stock options as compensation." ¶169. Indeed, plaintiff alleges that Defendants benefited from the misrepresentations of the Company's financials to the extent that they receive incentive-based compensation, as detailed in paragraph 156.

Finally, as acknowledged by defendants, the defendants are not immunized against claims of bad faith violations of the implied contractual covenant of good faith and fair dealing. In fact, here, plaintiff has demonstrated that the defendants acted in bad faith so as to render

MMA's exculpatory clause inoperable. *See e.g., Blackmore Partners, L.P. v. Link Energy LLC*, No. 454-N, 2005 WL 2709639 (Del. Ch. Oct. 14, 2005). Plaintiff has alleged that defendants acted and failed to act all in furtherance of their own self-interests (*see* ¶156). At the very least, the Court could find that the defendants' actions reached the level of gross negligence required to find a violation for the duty of due care. *See id.* at *8.

III. CONCLUSION

For the foregoing reasons, Plaintiff respectfully submits that Defendants' motions to dismiss should be denied.

Dated: June 11, 2007
Public Version Filed: June 26, 2007

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CERTIFICATE OF SERVICE

I, Carmella P. Keener, hereby certify that on this 26th day of June, 2007, I caused a copy of the Public Version of Plaintiff's Opposition to Defendants' Motion to Dismiss the Amended Shareholder Derivative Complaint to be served on the following by LexisNexis File & Serve:

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