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.	)	Civil Action No. 2404-VCL

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

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PRELIMINARY STATEMENT

Plaintiff's Opposition to Defendants' Motion to Dismiss the Amended Shareholder Derivative Complaint ("Opposition") does not, and cannot, establish a cognizable excuse for Plaintiff's failure to make a pre-suit demand on the Board of Directors for nominal Defendant Municipal Mortgage & Equity LLC ("MMA"). The Complaint should be dismissed in its entirety.

Because the Complaint allegations do not support her demand excuse arguments, Plaintiff resorts to hyperbole, repetition and a mélange of new factual assertions that neither appear in the Complaint nor are supported by the documents she appends to her Opposition. As a result, much of what Plaintiff argues in her Opposition bears little resemblance to what she pleads in her Complaint. Plaintiff, however, cannot obscure that the specific acts and omissions alleged in the Complaint, and the dearth of particularized facts she pleads to support them, are not sufficient to survive this motion.[1]

Plaintiff first asserts that a pre-suit demand would have been futile because a majority of the ten-member MMA Board is dominated and controlled by two allegedly interested Director Defendants.[2] Relying only on legally insufficient factual assertions not alleged in the Complaint, Plaintiff claims that "[a]ll 10 named Director Defendants have intertwining

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[1] As set out in Defendants' Opening Brief ("Def. Br.") and discussed below, the specific acts and omissions about which Plaintiff complains are that the MMA Board: (1) paid all of MMA's shareholders allegedly "excessive" dividends; (2) failed to oversee the Company's use of an accounting statistic known as "other than temporarily impaired"; (3) failed to oversee charitable contributions to non-profit entities that allegedly used the funds to service debt held by MMA; (4) approved certain asset transactions that earned "enormous profits" for MMA; and (5) approved performance-based compensation for Defendants Joseph and Falcone.

[2] Opp. at 13.

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."[3] Even if considered (which they cannot not be under well-settled Delaware law), Plaintiff's new extraneous facts serve only to confirm the independence of all of the Board's eight outside directors.

Alternatively, Plaintiff contends that demand would have been futile because all of the Director Defendants are "exposed to personal liability arising out of the acts Plaintiff complains of."[4] She acknowledges, as she must, that the Director Defendants are exculpated from personal liability unless they engage in "fraudulent or illegal conduct" or a "bad faith violation of the implied contractual covenant of good faith and fair dealing."[5] In trying to salvage her claims against this limitation, she argues that all of the Directors knowingly engaged in non-exculpated conduct because they allegedly "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."[6]

Plaintiff, however, pleads no facts showing that a single Director Defendant, much less a majority of them, had the requisite "culpable state of mind" necessary to state a claim based on allegedly "illegal conduct" or a "bad faith" failure of oversight. There are no asserted facts showing any actual knowledge on the part of any director that the alleged acts or omissions were improper. The Complaint does not even indicate what, if any, specific

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3 Opp. at 15.

4 Opp. at 17.

5 Opp. at 47-48.

6 Opp. at 18.

involvement ***any*** individual board member (much less all of them) had in implementing or reviewing the alleged accounting practices and transactions, other than the wholly conclusory and legally insufficient assertions that the Director Defendants "actively implemented" or "authorized" them.

Moreover, there are no cognizable "red flags" and certainly none that the MMA Board knowingly ignored. Plaintiff, in fact, does not dispute that before the filing of this lawsuit, no one -- not even the Plaintiff -- ever suggested to any member of the MMA Board that these accounting practices and transactions were somehow improper. Unlike the cases on which Plaintiff relies, no employee or officer of MMA, no regulator, no court, no accountant, no tax lawyer, no borrower or creditor and certainly no other shareholder is alleged to have given the MMA Board any indication whatsoever that the alleged practices and transactions were in any way improper or could even potentially compromise the integrity of MMA's financial reporting or its admittedly profitable businesses. Indeed, Plaintiff stands alone among MMA's thousands of investors and creditors (many of which are among the world's most sophisticated financial institutions) in claiming that MMA's publicly available financials and other disclosures demonstrate a "manipulative scheme" for which MMA's directors are responsible. Not surprisingly, therefore, the alleged harm to the Company resulting from Plaintiff's contrived improprieties is purely hypothetical and speculative and, quite simply, has not happened and does not exist.

ARGUMENT

I. THE MMA BOARD IS INDEPENDENT AND DISINTERESTED

Plaintiff claims that the Board lacks independence because all of its members are "beholden" to Defendants Joseph and Falcone and have a "strong shared financial interest and personal allegiance…among one another."[7]

There is nothing in the Complaint to support this contention.[8] Plaintiff implicitly concedes as much by reciting in her Opposition a litany of newly-asserted and legally insufficient facts that do not appear in her Complaint.[9] Even if the Court allowed Plaintiff to amend her Complaint again (she already amended once in lieu of responding to Defendants' original motion to dismiss), these new factual assertions do not show that any outside director was beholden to Defendants Falcone and Joseph or any other director.

Delaware law is clear that a plaintiff asserting that one of more directors is dominated or controlled by another "must allege particularized facts manifesting a 'direction of corporate conduct in such a way as to comport with the wishes or interests of the corporation (or persons) doing the controlling.'"[10] "Allegations of mere personal friendship or a mere outside

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7 Opp. at 15. Plaintiff apparently no longer asserts that mere ownership of stock options renders every member of the MMA Board incapable of impartially considering a demand. Compl. ¶ 169. Plaintiff appears to have abandoned this flawed contention for the reasons set forth in the Director Defendants' Opening Brief. Def. Br. at 22-25.

8 Def. Br. at 13-17. Indeed, the only Complaint allegation to that effect is the vague assertion that "members of the Board acted under the dominance and control of the individuals who primarily benefited from the transactions ratified by the Board." Compl. ¶¶ 163, 169. Plaintiff does not contest that this wholly conclusory allegation is insufficient under Delaware law to establish a lack of independence.

9 Opp. at 15-16.

10 *Aronson*, 473 A.2d 805, 816 (Del. 1984).

business relationship, standing along, are insufficient to raise a reasonable doubt about a director's independence."[11] Applying these principles to the new facts asserted in Plaintiff's Opposition confirms the independence of no fewer than six of the Board's ten directors:

1. With respect to Defendants McGregor and Mehlman, Plaintiff does not identify ***any*** additional new facts, resting only on the bare allegation in the Complaint that these two Directors served on the MMA Board.

2. With respect to Defendant Baum, the only new assertion Plaintiff can muster is that he donated money to Center Stage, a theater for which the wives of Defendants Brown and Falcone serve on the Board of Trustees.[12] Plaintiff does not, and cannot, explain how a charitable donor (who receives no personal gain from his charity) is beholden to his beneficiary, much less beholden to someone who is only indirectly connected to that beneficiary through his spouse. Nor does Plaintiff cite any case law to support such an illogical conclusion.[13]

3. With respect to three other outside Directors (Hillman, Brown and Lucas), Plaintiff asserts only that: (a) Hillman donated money to the Center Stage; (b) Hillman's wife

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[11] *Beam ex rel. Martha Stewart Living Omnimedia Inc. v. Stewart*, 845 A.2d 961, 1050 (Del. Ch. 2003).

[12] Opp. at 16.

[13] *See, e.g.*, *In re Fannie Mae Deriv. Litig.*, Civ. A. No. 04-1783 (RJL), 2007 WL 1577872, at *8-11 (D.D.C. May 31, 2007) (allegations that director defendants lacked independence because they made charitable contributions to entities with which some of the directors were affiliated, engaged in purported business relationships with each other and their family members, and failed to oppose inside directors were dismissed on the grounds that "merely alleging that several directors work together outside the company on a few boards of unaffiliated companies…is not enough to raise a reasonable doubt about a director's independence."); *In re J.P. Morgan Chase S'holders Litig.*, 906 A.2d 808, 822 (Del. Ch. 2005) (allegation that director was a trustee of a museum that received charitable contributions made by company was insufficient to establish "domination and control");

serves on the board of a civic organization, the Greater Baltimore Committee, with Defendants Joseph and Brown; (c) Brown serves on the Board of Mercantile Bankshares with Defendant Berndt; and (d) Lucas serves on the Board of Provident Bankshares with Defendant Joseph.[14] Again, however, Plaintiff offers no explanation as to how these indirect relationships and joint service on unaffiliated, multi-member boards make these Defendants somehow beholden to Defendants Joseph and Falcone or to each other.[15]

The independence of these six directors alone is sufficient to conclude that the MMA Board could impartially consider a pre-suit demand. But Plaintiff's allegations with respect to the two other outside directors – Defendants Berndt and Pratt – also are deficient because they are not particularized and fail to explain why Berndt and Pratt would be incapable of impartially considering a demand.[16] Plaintiff's Opposition does not contest that showing and Berndt and Pratt, therefore, are independent as well.

II. PLAINTIFF FAILS TO ALLEGE WITH PARTICULARITY THE REQUISITE SCIENTER NECESSARY TO PLEAD A NON-EXCULPATED CLAIM

Plaintiff's alternative demand excuse argument is that the Director Defendants confront a substantial likelihood of personal liability arising out of the matters alleged in the Complaint.[17] Delaware law, however, is clear that a "serious threat of liability may only be

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14 Opp. at 15-16.

15 *See, e.g.*, *Stein v. Orloff*, 1985 WL 11561, at *4 (Del. Ch. May 30, 1985) (allegations of "extensive business relationships" were insufficient to excuse the failure to make demand because "[n]o facts [were] alleged which suggest[ed] that the directors would not have retained their positions unless they acted in accordance with [the controlling director's] wishes.").

16 Def. Br. at 21-22.

17 Opp. at 17.

found to exist if the plaintiff pleads a *non-exculpated* claim against the directors based on particularized facts."[18] Although Plaintiff does not contest this well-established standard, she plainly fails to meet it.

A. Plaintiff Fails To Plead Fraudulent Or Illegal Conduct Or A Bad Faith Breach Of Contract

Plaintiff does not dispute that the exculpatory provision of MMA's Operating Agreement protects the Director Defendants against any liability "for any act or omission performed or omitted by him or her, or for any decision, except in the case of fraudulent or illegal conduct of such person."[19] Plaintiff also does not dispute that the Delaware Limited Liability Act ("LLCA") allows a limited liability company like MMA to "eliminate any and all liabilities" of its directors, including liability for breach of any fiduciary duty, so long as it does not exculpate for breach of contract claims based on a "bad faith violation of the implied contractual covenant of good faith and fair dealing."[20]

MMA's exculpation provision, therefore, eliminates any threat of personal liability, including liability for alleged breaches of fiduciary duties, not based on "fraudulent or illegal conduct" or a "bad faith" breach of contract. Thus, to sustain her personal liability demand excuse argument, Plaintiff must plead particularized facts showing that a majority of the

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[18] *Guttman v. Huang*, 823 A.2d 492, 501 (Del. Ch. 2003). Plaintiff does try to muddle the point that pleading with particularity is required by suggesting she can survive the motion to dismiss if her claims meet the less stringent notice pleading standard. Opp. at 23-24. But where, as here, the Plaintiff must plead her claims about director liability with particularity under Rule 23.1, the law is clear that mere notice pleading does not suffice and the underlying claim for relief against the directors must be plead with particularity. *See, e.g.*, *Guttman*, 823 A.2d at 501; *In re Fannie Mae Deriv. Litig.*, 2007 WL 1577872, at *1 (failure to sufficiently plead demand futility established necessary predicates for dismissal based on failure to state a claim).

[19] Def. Br. at 26.

[20] Def. Br. at 26-27; Opp. at 47.

Director Defendants engaged in fraudulent or illegal conduct or breached the MMA Operating Agreement in bad faith. Her complaint fails to do so.

First, Plaintiff apparently concedes that she has not pled with particularity any claim based on fraudulent conduct. Nowhere in her Opposition does she address the elements of a fraud claim or attempt to explain how she pleads those elements with the requisite degree of particularity. Indeed, as noted in Defendants' Opening Brief, Plaintiff's conclusory assertions about a "campaign of deceit" or "material misrepresentations" do not suffice under Delaware law to state a claim for fraud with particularity.[21]

Second, Plaintiff does not explain how her allegations set out a non-exculpated claim for a "bad faith violation of the implied contractual covenant of good faith and fair dealing." Instead, she summarily asserts that "the defendants acted in bad faith so as to render MMA's exculpatory clause inoperable."[22] What Plaintiff fails to recognize is that a claim alleging a non-exculpated "bad faith violation" is a contractual one that, essentially, asserts that a party complied with the letter, but not the spirit, of a specific contractual provision.[23] Plaintiff here studiously ignores the contractual duties of the Board as detailed in MMA's Operating Agreement and does not even purport to allege any breach of contract claim whatsoever.

Third, even if a "bad faith" claim not based on any specific contractual breach is outside the scope of the exculpated conduct, Plaintiff fails to allege any such claim with particularity. And, she plainly fails to adequately plead that a majority of the Director

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21 Def. Br. at 27-29.

22 Opp. at 49-50.

23 Def. Br. at 30-32.

Defendants knowingly engaged in "illegal conduct."[24] As Vice Chancellor Strine recently explained in *Desimone v. Barrows* an exculpation provision that eliminates liability except for claims based on "bad faith" or a knowing violation of law requires a plaintiff to plead particularized facts that reveal the state of mind of each individual director.[25]

In *Desimone*, Plaintiff alleged that the defendant directors breached their fiduciary duties by approving a number of backdated stock options.[26] Even though the court accepted as true the allegation that backdated options were approved by the board, it refused to infer – in the absence of particularized allegations – that they were approved ***with the knowledge*** that they had been improperly backdated.[27] The court dismissed the plaintiff's claims concluding that "the complaint fail[ed] to plead demand excusal" because "Desimone has not plead facts suggesting an inference that the Sycamore board knowingly granted Sycamore's officers backdated options."[28]

To explain this outcome, the court in *Desimone* contrasted two scenarios.[29] The first scenario described a situation where directors approved a series of transactions without

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24 Opp. at 48-49.

25 *Desimone v. Barrows*, C.A. No. 2210 (LES), 2007 WL 1670255, at *16 (Del. Ch. June 7, 2007).

26 *Id.* at *1.

27 *Id.* at *24.

28 *Id.* The *Desimone* court also rejected the contention that "knowledge on the part of any one board member can be imputed to other board members as a result of their shared board of committee service." *Id.* at 25. Therefore, if the court here were to conclude that Joseph or Falcone, the inside directors, knew that the alleged transactions were improper, that knowledge could not be imputed to other board members. *See also Rattner v. Bidzos*, No. Civ. A. 19700, 2003 WL 22284323, at *11 (Del. Ch. Oct. 7, 2003) (holding that directors cannot be charged with knowledge of information merely because they served on a board with a director who may have known such information).

29 *Desimone*, 2007 WL 1670255, at *17-18.

realizing that the transactions were improper.[30] The second scenario described a situation where the directors approved a series of transactions knowing that the transactions were improper.[31] Although the directors approved the improper transactions in both scenarios, the court explained that the directors in the first scenario would be "protected from liability" because "they did not act with scienter."[32]

The same "scienter" requirement applies to claims based on an alleged failure of oversight. For the Defendant Directors to be personally liable for such claims, Plaintiff must plead particularized facts showing that the Directors either "knew or should have known that violations of law were occurring" and "took no steps to prevent or remedy the situation."[33] Where, as here, a plaintiff's claims are premised on a failure of oversight, "only a sustained or systematic failure of the board" is sufficient to "establish the lack of good faith that is a necessary condition to liability."[34]

These principles recognize that "absent grounds to suspect deception, neither corporate boards nor senior officers can be charged with wrongdoing for simply assuming the integrity of employees and the honesty of their dealings on the company's behalf."[35] Thus, "[i]n 'the absence of red flags, good faith in the context of oversight must be measured by the directors' actions 'to assure a reasonable information and reporting system exists' and not by

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30 *Id.* at *17.

31 *Id.*

32 *Id.* at *18.

33 *In re Caremark Int'l Deriv. Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996) (internal numbering omitted).

34 *Id.*

35 *Caremark*, 698 A.2d at 969.

second-guessing after the occurrence of employee conduct that results in an unintended adverse outcome."[36]

B. Plaintiff Fails To Plead Scienter With Respect To The Specific Acts And Omissions Alleged In The Complaint

Here, with respect to each of the specific improprieties alleged in the Complaint, there are no particularized facts sufficient to support an inference that a majority of the Director Defendants knowingly engaged in improper or illegal conduct, or in bad faith abdicated their oversight responsibilities:

1. Excessive Dividends. Plaintiff claims that the Board improperly issued "excessive dividends."[37] But her Opposition does not contest that the dividends were issued in compliance with the LLCA or the MMA Operating Agreement.[38] Her claim, therefore, is not that the Board "could not" issue the challenged dividends but that the Board "should not" have exercised its discretion to do so. Such a business judgment is left to the Board under both the law and MMA's Operating Agreement, not to an individual shareholder second-guessing that judgment in a derivative lawsuit. And, in any event, there is nothing in the Complaint that would allow the court to infer that the Board had any reason to think that its award of dividends was outside of its authority or in any way improper.[39]

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36 *Stone v. Ritter*, 911 A.2d 362, 373 (Del. 2006), *quoting*, *Caremark*, 698 A.2d at 967-68, 971.

37 Comp. ¶¶ 32-33; Opp. at 2.

38 Def. Br. at 9. Plaintiff, for example, does not deny that the Board properly may take into account working capital when assessing whether assets exceed liabilities sufficient to support the dividends as permitted under the LLCA. Nor does she deny that her allegations to the effect that dividends were "excessive" failed to take working capital into account. *Id.*

39 Def. Br. at 41. Ironically, Plaintiff's Complaint alleges (falsely) that MMA took on too much debt for the supposed purpose of funding the allegedly excessive dividends.

2. "Other Than Temporarily Impaired." Plaintiff baldly asserts that the "Director Defendants caused the Company to conceal the true extent of the impairment of its assets" with the "knowledge that the Company had engaged in accounting practices that violated GAAP and its own internal policies."[40] Similarly, Plaintiff claims, without any support whatsoever, that the "Audit Committee also was appraised of failures to take other-than-temporary impairment charges."[41] Plaintiff, however, does not allege any facts showing that the Board had actual knowledge that this accounting statistic (referred to as FAS 115) was being improperly applied. Instead, Plaintiff principally argues that the Board must have known that FAS 115 was being improperly applied because MMA's financial statements assigned a value to some of the Company's assets that was higher than some offers the Company had received for those assets.[42] The Complaint, however, does not indicate whether, how or by whom the Board was advised about the prospective bids (which the Company rejected because they were inadequate). Plaintiff does not even suggest a plausible reason why the Board would have been advised of offers that MMA employees considered inadequate.

Compl. ¶¶ 32-33. Plaintiff's Opposition reverses course, claiming (based on facts not alleged in the Complaint) that MMA is somehow doing something wrong because it has taken steps to reduce its debt. Opp. at. 10. Such alleged facts that are not contained in the Complaint cannot now be considered on a motion to dismiss. *See In re General Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 168 (Del. 2006) ("a trial court is required to accept only those reasonable inferences that logically flow from the face of the complaint and is not required to accept every strained interpretation of the allegations proposed by the plaintiff.") (internal quotations omitted). Yet, if they are, the documents appended to the Opposition make clear that these reductions in MMA's lines of credit were done at MMA's request and are not a consequence of the matters alleged in the Complaint. Opp. at Ex. B.

40 Opp. at 21, 48.

41 Opp. at 18.

42 Compl. ¶¶ 88, 92; Opp. at 6.

Nor are there any facts suggesting that any Director, much less all of them, was told or advised that MMA's accountants were not properly applying this accounting statistic.[43] As this Court has held, "red flags are only useful when they are either waived in one's face or displayed so that they are visible to the careful observer."[44] Thus, Plaintiff's allegations fall far short of facts sufficient to show that every member of the MMA Board knowingly manipulated MMA's financial reporting about these assets, even if the Court were to infer that every member of the Board knew about the portfolio offering.[45]

3. Charitable Contributions. Plaintiff wants the Court to infer that the MMA Board willfully exposed the Company to tax liability by knowingly authorizing charitable contributions that allegedly were used by the beneficiaries to service MMA debt.[46] Again, there are no particularized facts to support this claim. Plaintiff concedes that the MMA Board does

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43 The Complaint itself reflects the reason for this pleading omission. MMA, as it explained in its disclosures that are quoted in the Complaint, subsequently sold some of these very same assets for at or near their full reported value, consistent the proper application of FAS 115 in MMA's financials. Def. Br. at 12; Compl. ¶ 104. Moreover, here, as in *Guttman*, mere membership on an audit committee is not enough to infer the requisite scienter, notwithstanding Plaintiff's summary assertion to the contrary. Opp. at 20-22.

44 *Rattner*, 2003 WL 22284323, at *13, *quoting*, *In re Citigroup Inc. S'holders Litig.*, No. 19827 (SPL), 2003 WL 21384599, at *2 (Del. Ch. June 5, 2003) (internal quotations omitted).

45 Incorrectly asserting that the assets for which inadequate offers were received and rejected were so substantial as to warrant Board attention, Plaintiff cites *In re Electronic Data Systems Corp. Sec. and ERISA Litig.*, 298 F. Supp. 2d 544, 557 (E.D. Tex. 2004) for the proposition that knowledge on the part of individual directors can be inferred from "the magnitude and importance of a key asset to the company." Opp. Br. at 21. The court in that case, however, concluded that the defendants had actual knowledge of the alleged wrongdoing based on plaintiffs particularized allegations and "significant documentary evidence" showing "specific meetings, reports, and practices whereby [the defendants] were made actually aware of the [wrongdoing]." *Id.* at 548 n.7, 557 (emphasis added).

46 Compl. ¶ 47; Opp. at 26.

not even decide what entities will ultimately receive its charitable contributions.[47] And Plaintiff offers no facts that suggest that the MMA Board influences in any way how a downstream beneficiary may decide to use funds that may have originated with MMA.[48] But, most importantly, Plaintiff does not identify any facts that suggest that any member of the Board, much less a majority of them, had any reason to think that a non-profit beneficiary's use of funds that originated with MMA could, in any way, be illegal or improper.[49] If anything, the Complaint confirms that the Board believed that any such use would ***not*** be improper, inasmuch as it recites MMA's public disclosures that charitable contributions might be used for such purposes.[50]

4. "Improper Asset Transactions." Plaintiff claims that the MMA Board knowingly approved of related-party transactions that resulted in the Company making "enormous profits."[51] Nonsensically, Plaintiff claims that these successful transactions were improper because MMA and its shareholders realized profits that MMA should have yielded to the allegedly related parties.[52] Plaintiff contends that keeping these profits for MMA's shareholders exposed MMA to potential tax liability by failing to preserve tax-exempt status for the assets involved.[53] Nothing in the Complaint, however, indicates that anyone ever advised the

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47 Compl. ¶¶ 51, 53, 55.

48 Def. Br. at 10.

49 Def. Br. at 10.

50 Compl. ¶¶ 51-55.

51 Compl. ¶¶ 110-46; Opp. at 26.

52 Compl. ¶ 133.

53 Compl. ¶¶ 137-146; Opp. at 10.

MMA Board that Plaintiff's interpretation of the tax laws had any merit or that earning enormous profits at the expense of allegedly related parties would somehow be improper.[54] Instead, Plaintiff wants this Court to infer that all of the Director Defendants knew that violations of law were occurring based solely on the fact that the Board is required to approve all related-party transactions.[55] Delaware law is clear that board approval of a transaction, even one that later proves to be improper, is an insufficient basis for inferring culpable knowledge on the part of individual directors.[56]

5. Executive Compensation. Plaintiff's Opposition all but abandons her contention that a majority of the MMA Board could be personally liable for approving performance-based compensation for Defendants Falcone and Joseph. And Plaintiff certainly has abandoned any notion that such approval would amount to a knowing violation of law. As set out in Defendants' Opening Brief, and not challenged in Plaintiff's Opposition, Plaintiff has not alleged any facts suggesting that a majority of the Board "personally acted without honesty and good faith" in approving the performance-based compensation.[57]

Thus, while the Complaint is replete with conclusory assertions that the Defendants' "knew of should have known" about the alleged accounting "manipulation" and "improper transactions" it is "entirely devoid of particularized allegations of fact demonstrating that the outside directors had actual or constructive notice of the [alleged] improprieties." So

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54 Def. Br. at 13. Indeed, it is near certain that, had the MMA Board ceded those profits to the allegedly related parties, this Plaintiff would have claimed that the Board somehow breached its fiduciary duties in doing so.

55 Opp. at 26; Compl. ¶¶ 47-56, ¶¶ 85-134.

56 *Desimone*, 2007 WL 1670255, at *24.

57 Def. Br. at 44.

vague and indefinite are the Plaintiff's "scienter" allegations that she herself cannot decide whether any Director Defendant had the requisite culpable state of mind to knowingly engage in non-exculpated "bad faith" or "illegal conduct." She speculates, on the one hand, that the Director Defendants were not adequately informed or were "reckless in not knowing" of the allegedly improper practices.[58] On the other hand, she claims that the Director Defendants "knew the true state of affairs" and knowingly "caused the Company to conceal" the true financial condition of the Company.[59] Her ambiguity in this regard is understandable, given the utter lack of any particularized facts sufficient to show the state of mind with which each Director acted, or failed to act, with respect to the alleged practices and transactions.

C. The Restatement Of Earnings Confirms The Board's Diligence

Turning logic on its head, Plaintiff claims that the Company's restatement of earnings "evinc[es] Defendants' grossly inadequate monitoring and understanding of the Company's dire financial position and reporting controls."[60] Plaintiff does not contest, however, that the restatement had nothing to do with the any of the five specific acts and omissions alleged in the Complaint.[61] She also does not contest that the restatements came about because the Company monitored internal reporting and information systems and proactively uncovered accounting irregularities that the Board addressed well before the Complaint in this matter was filed. The notion that such vigilance should somehow "evinces grossly inadequate monitoring"

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58 Opp. at 40-41.

59 Opp. at 48-49.

60 Opp. at 28.

61 Plaintiff, instead, generically that the restatements relate to the Company's "tax exempt portfolio," trying to create the impression (without any supporting facts) that the restatements involve the matters alleged in the Complaint. Opp. at 9, n.14.

should not be countenanced. If it were, then no board could ever act in response to concerns about accounting systems and controls without being sued immediately thereafter. Delaware law does not permit such an anomaly.

For these reasons, Plaintiff has not adequately pled with particularity a non-exculpated claim sufficient to establish a serious threat of liability that would disable the independent and disinterested MMA Board from impartially considering a pre-suit demand.

III. THE CASES ON WHICH PLAINTIFF HERSELF RELIES CONFIRM THAT HER COMPLAINT SHOULD BE DISMISSED

Conspicuously omitted from Plaintiff's Opposition was any discussion of the instructive decisions in several cases that involved closely analogous facts and virtually identical demand excuse arguments. Plaintiff, for example, completely ignores the Chancery Court's recent decision in *Desimone*, discussed above, which rejected the assertion that board approval of certain actions creates an inference of improper motive or a knowing violation of law.[62]

Plaintiff also ignores the recent decision in *Fannie Mae* and the oft-cited Chancery Court's opinion in *Guttman*, two cases in which derivative claims based on alleged accounting irregularities were dismissed for failure to make a pre-suit demand.[63] And Plaintiff makes only a passing reference to the decision in *Rattner*, which also rejected derivative claims about alleged accounting irregularities much like those alleged here. The court in *Rattner* refused to infer a culpable state of mind based only on allegations that certain board members served on an audit committee and, therefore, should have been aware of the facts on which

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62 *Desimone*, 2007 WL 1670255.

63 *See In re Fannie Mae*, 2007 WL 1577872, at *8 (dismissing derivative claims for failure to make a pre-suit demand where allegations failed to show that a majority of the directors knowingly violated the law); *Guttman*, 823 A.2d 492.

Plaintiff premised her interpretation of "SEC rules and regulations, and FSAB and GAAP standards."[64]

These cases, as well as the Delaware Supreme Court's recent decision is *Stone*, all confirm that where, as here, a complaint lacks particularized facts showing that the majority of the Board had a "culpable state of mind," demand cannot be excused on the basis of personal liability.[65] The result in this case should follow this well-reasoned precedent.

The cases upon which Plaintiff relies confirm this principle. Unlike the Complaint here, the pleadings in the cases Plaintiff cites alleged particularized facts on which the court could conclude that the directors were aware of the alleged misconduct, knew it was unlawful, and failed to do anything about it. These cases, in fact, confirm what is missing from Plaintiff's complaint: particularized factual allegations about the state of mind of the directors.

Plaintiff, for example, repeatedly cites *McCall v. Scott*.[66] The particularized facts alleged in that case demonstrated that the board had been given ample notice of the alleged improprieties related to the company's billing practices, including: (a) internal audit reports, presented to the board, that detailed company activities that identified "possible violations of law;" (b) statistical evidence brought to the board's attention suggesting that company's billing practices were awry; (c) prior lawsuits challenging the company's billing practices; (d) federal investigations and raids of the companies facilities to collect evidence of the company's billing

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64 *Rattner*, 2003 WL 22284323. Plaintiff weakly tries to distinguish *Rattner* on the basis that it involved only "a single accounting statistic." Opp. at 21 n.18. But here, as well, Plaintiff's case revolves around a single accounting statistic (FAS 115). In all events, Plaintiff's distinction is one without a difference. The salient point established in *Rattner* and the other cases noted above is that particularized facts showing a culpable state of mind are required to withstand a motion to dismiss. None here are plead.

65 *Stone*, 911 A.2d 362.

66 Opp. at 19, 24-26, 31-33, 37.

practices; and (e) a series of *New York Times* articles revealing that the company's billing practices were out of line with those of its competitors.[67] No such particularized facts are alleged here.

Plaintiff also cites *In re Veeco*, a federal court derivative action alleging that a board of directors breached its fiduciary duties by failing to oversee, monitor and manage the internal accounting controls of the company and maintain compliance with federal export control laws.[68] In that case, the plaintiffs alleged particularized facts showing that the board of directors received actual notice from an employee of the company that violations of federal export controls laws had occurred. Faced with this knowledge, the board took no action to improve its control environment. As a result, a second violation of law occurred seven months later.[69] No such particularized facts are alleged here.

Similarly, the court in *In re Abbott Labs*, also cited by Plaintiff, found it reasonable to infer that the directors knew that violations of law were occurring based on particularized allegations showing that the Food & Drug Administration ("FDA") had conducted thirteen inspections of two Abbott facilities, determined that both facilities were not in compliance with FDA regulations and issued four warning letters to Abbott over a six-year period urging Abbott to comply with its regulations.[70] The Abbott board took no action to comply and stated publicly that it disagreed with the FDA's findings, confirming that it was aware of the alleged conduct and acknowledging that a regulator thought it was illegal. Abbott

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67 239 F.3d 808, 820-23 (6th Cir. 2001).

68 *In re Veeco Instruments, Inc. Sec. Litig.*, 434 F. Supp. 2d 267 (S.D.N.Y. 2006).

69 434 F. Supp. 2d at 277-78.

70 *In re Abbott Labs. Deriv. S'holder Litig.*, 325 F.3d 795, 799-800 (7th Cir. 2001).

eventually settled with the FDA after agreeing to pay $100 million fines and destroy $250 million worth of adulterated drugs.[71] No such particularized facts are alleged here.

Likewise, the plaintiff in *Ryan v. Gifford* alleged that the defendant directors deliberately violated a shareholder stock option plan by approving backdated stock option grants.[72] Because the Board had no discretion to determine the date of the options grants, and because the plaintiff alleged particularized facts showing that the options were dated in direct violation of the Board's obligations,[73] the court concluded that it was reasonable to infer that the manipulation of the option dates was intentional and done in knowing in contravention of the express terms of the stock option plan.[74]

Here, in marked contrast to the cases Plaintiff cites, there are no specific facts alleged sufficient to show that any member of the MMA Board knowingly engaged in illegal conduct or in bad faith failed to prevent such conduct to the detriment of MMA or its shareholders. This case is, instead, a replay of the insufficient claims dismissed in *Stone*, *Guttman*, *Rattner*, *Fannie Mae*, and *Desimone* where the plaintiff failed to allege any "reasons why particular defendants should have been on notice of the accounting irregularities"[75] where mere board approval or audit committee membership were insufficient, and where no facts suggested that the Board knowingly allowed or participated in a violation of law.[76]

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71 *Id.* at 801.

72 *Ryan v. Gifford*, 918 A.2d 341, 347-48 (Del. Ch. 2007)" .

73 *Id.* at 354.

74 *Id.* at 355, 355 n.34.

75 *Guttman*, 823 A.2d at 498.

76 To the extent that they are predicated on "bad faith" or "illegal conduct," Plaintiff's ancillary claims of gross mismanagement, unjust enrichment and waste fail for the same

CONCLUSION

For the reasons set forth above and in Defendants' Opening Brief, Plaintiff's Complaint should be dismissed in its entirety.

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reasons Plaintiff's duty claims fail. To the extent that Plaintiff's ancillary claims are not based on "bad faith" or "illegal conduct" they are plainly barred by the exculpation provision in the MMA Operating Agreement. In either case, Plaintiff's ancillary claims should be dismissed.