IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE RAIT FINANCIAL TRUST SECURITIES LITIGATION	Master File No. 2:07-cv-03148-LDD

LEAD PLAINTIFF'S MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' MOTIONS TO DISMISS THE CONSOLIDATED CLASS ACTION COMPLAINT

BERNSTEIN LITOWITZ BERGER & GROSSMANN LLP
Chad Johnson
Gerald H. Silk
John C. Browne
John Rizio-Hamilton
1285 Avenue of the Americas
New York, New York 10019
Tel: (212) 554-1400
Fax: (212) 554-1444

Attorneys for Court-Appointed Lead Plaintiff Brahman Capital Corp. and Lead Counsel for the Class

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Court-Appointed Lead Plaintiff, Brahman Capital Corp., on behalf of Brahman Partners II, L.P., Brahman Partners III, L.P., B Y Partners, L.P., Brahman C.P.F. Partners, L.P., and Brahman Partners IV, L.P. ("Lead Plaintiff") and Employees' Retirement System of the State of Rhode Island ("Rhode Island") respectfully submit this memorandum of law in opposition to Defendants' motions to dismiss the Consolidated Class Action Complaint (the "Complaint").[1]

PRELIMINARY STATEMENT

This litigation arises from the fraudulent activities of RAIT, a real estate finance company, and its senior executives. During the Class Period, RAIT and its senior executives intentionally misled investors about the Company's exposure to hundreds of millions of dollars of troubled and impaired debt. Bolstered by Defendants' false statements, the price of RAIT's publicly traded securities steadily increased and the Company (with the assistance of its underwriters and accountant) was able to raise $855 million from investors in three separate securities offerings.

Defendants' false statements enabled RAIT to portray itself as a conservative and profitable company even as real estate markets across the country experienced sharp downturns. As described below, prior to and during the Class Period the real estate industry experienced a steep increase in the number of foreclosures and mortgage defaults. Numerous real estate

[1] Lead Plaintiff's memorandum of law is submitted pursuant to this Court's February 29, 2008 Order permitting Lead Plaintiff to file a single omnibus memorandum of law in opposition to all defense motions and with a page limit of 115 pages. *See* Docket #69. As discussed below, Defendants have not challenged certain of the allegations in the Complaint and have therefore waived any arguments relating to those allegations. In the interests of efficiency, this memorandum of law responds in fewer than the allotted 115 pages to Defendants' arguments and, pursuant to Your Honor's Individual Procedures, all pending motions to dismiss are now fully briefed.

companies came under severe financial pressure and reported declining earnings, bleak future prospects and significant liquidity concerns. ¶¶82-111, 234-43, 252-55, 260-66, 277-86, 309.[2]

In the face of these worsening conditions, Defendants repeatedly told investors that RAIT took a "conservative stance" towards its credit exposure (¶¶249, 272), financed only "cream-of-the-crop" real estate companies (¶70), was "dedicated to pristine credit" (¶349), had "very, very limited subprime exposure," which was "de minimis" (¶250), "totally hedged out" (¶85), and "immaterial to [its] balance sheet overall" (¶275). Investors were forced to rely on Defendants' assurances because RAIT did not disclose the specific companies to which it was exposed (citing supposed "inside information" they had regarding those companies' financial results). Instead, Defendants told investors that they continually monitored RAIT's assets for potential credit impairment, and Defendant Daniel Cohen, RAIT's Chief Executive Officer, assured investors on multiple occasions that RAIT's total potential exposure was "in the single basis point" and was "less than $13 million across the whole entire portfolio." ¶¶131-32, 250, 275. Tellingly, Defendants do not challenge the falsity of any of their quoted statements above.

These statements (and many others detailed in the Complaint and below) were brazen falsehoods. As RAIT has since admitted, the Company had over $622 million in impaired assets and remaining exposure to troubled real estate companies, and at least $315 million of that debt eventually defaulted. When investors learned the truth about RAIT, the price of the Company's common stock plummeted by more than 61%, causing hundreds of millions of dollars in investor losses. One analyst reacted to Daniel Cohen's assertion that the Company had only learned the need to take write-downs at the end of the Class Period by stating, "I guess the first thing that

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[2] Citations to "¶_" refer to the particular paragraph of the Complaint being cited; citations to "RAIT Mem. at _" refer to Docket #76.2; citations to "Tr. Mem. at _" refer to Docket #72; citations to "GT Mem. at _" refer to Docket #70; and citations to "UW Mem. at _" refer to Docket #77. Unless otherwise noted, all capitalized terms used herein are defined as in the Complaint.

comes to mind for me is the John McEnroe quote, 'You can't be serious, here.'" ¶¶7, 298 (emphasis added).

As set forth in the Complaint, the story behind the fraud at RAIT involves a complex web of family relationships that allowed RAIT's insiders to profit at the expense of public investors. On June 8, 2006, RAIT, a real estate investment trust that was founded by Betsy Cohen in 1997, announced an agreement to acquire Daniel Cohen's company, Taberna Realty Finance Trust ("Taberna"). Daniel Cohen told investors that the "most important element" of the merger was that Taberna had "no risks in terms of [its] underlying finance structure." ¶68. The merger occurred only after Taberna was unable to complete a planned initial public offering ("IPO") and failed to locate another public company to serve as a merger partner. By agreeing to merge her publicly-traded company (RAIT) with her son's company (Taberna), Betsy Cohen gave Taberna access to the public capital markets and the ability to raise hundreds of millions of dollars from investors. As alleged in the Complaint, this was not the first time, nor would it be the last, that the Cohens would use RAIT as a vehicle to convert their family and personal interests into a slew of related-party business transactions designed to further their own interests.

Despite these undeniable facts, each Defendant has moved to dismiss this "potentially massive securities fraud action" (GT Mem. at 2) at the pleading stage—before any discovery has taken place. They do so by ignoring or distorting the allegations of the Complaint and making highly factual arguments that have no place on a motion to dismiss.

Defendants' primary argument is that the 146-page Complaint fails to identify a single actionable misstatement. That is wrong. (Indeed, the Underwriter Defendants acknowledge that "almost half of the Complaint deals with allegedly fraudulent statements by RAIT." UW Mem. at 1.) To begin with, Defendants Daniel Cohen, Betsy Cohen and Jack Salmon completely ignore the Complaint's detailed allegations relating to the material false statements they made on conference calls with investors on June 9, 2006 (¶¶68-71), November 3, 2006 (¶85), February 22, 2007 (¶¶248-51), and May 1, 2007 (¶¶272-76). On these calls, Defendants told investors, among other things, that "market conditions are favorable for our business," RAIT's "credit quality remains strong" and RAIT had "very, very limited subprime exposure" that was "just less than $13 million" and "immaterial to our balance sheet overall" (¶¶272, 275). These were blatantly false statements that were directly contradicted by contemporaneous facts in Defendants' possession (indeed, the amount of RAIT's exposure was subsequently revealed to be in excess of $620 million). Apparently recognizing that they cannot defend these statements, Defendants do not even try. Thus, there is no dispute that the Complaint adequately alleges that these statements were materially false and misleading.

Defendants try to argue that the Complaint fails to adequately allege the falsity of their statements relating to RAIT's purported compliance with GAAP and its misstatements of net income, income from operations, and earnings per share. RAIT Mem. at 17-21, 26. The Complaint, however, sets forth numerous detailed factual allegations establishing that GAAP required RAIT to write-down the value of its credit portfolio. ¶¶140-49, 307-15; *see also* ¶¶82-111, 234-43, 252-55, 260-66, 277-86, 309 (setting forth liquidity and cash flow impairments suffered by RAIT's borrowers and describing declining market conditions overall). This write-down—which RAIT did not take until after the Class Period (after Defendants had raised $855 million from public investors)—would have wiped out the Company's reported net income for the entire Class Period. ¶¶147-48.

Defendants respond that no write down was required by making complex factual assertions regarding "judgment calls" and the "proper" application of GAAP. *See* RAIT Mem. at

17-21; GT Mem. at 2, 11-17. For instance, Grant Thornton argues that its decision to certify RAIT's false and misleading financial statements was an "exercise of business judgment" that cannot be challenged in this litigation. GT Mem. at 2; *see also id.* at 14 (arguing that "whether a decline in fair value is other than temporary is a matter of judgment"). These arguments are nothing more than bald assertions that the well-pled allegations of the Complaint supposedly will be proven wrong through expert testimony and the like, and these types of arguments are misplaced on a motion to dismiss (as Lead Plaintiff will show in discovery, they are also incorrect).

Defendants similarly argue that the Complaint is an attempt to plead "fraud by hindsight." RAIT Mem. at 2, 19; UW Mem. at 2, 9-17. This again ignores the Complaint's detailed allegations of contemporaneous facts in Defendants' possession during the Class Period that rendered Defendants' statements false and misleading when made. *See, e.g.* ¶¶82-84, 96-103, 107-11, 140-49, 235-43, 253-55, 260-66, 277-88, 309. As set forth below, the Complaint alleges particularized facts regarding the already poor (and further worsening) conditions in the real estate market and the severe difficulties faced by RAIT's TruPS issuers (the identities of which were not disclosed to investors.) These facts were in Defendants' possession and directly contradicted the statements they made to investors. These are not allegations of "fraud-by-hindsight," they are allegations of fraud at the time. A recent decision by the First Circuit confirms that the "fraud-by-hindsight" doctrine does not apply here. In *Mississippi Pub. Employees' Ret. Sys. v. Boston Scientific Corp.*, 523 F.3d 75, 89 (1st Cir. 2008), the First Circuit reversed a district court's application of the "fraud-by-hindsight" doctrine on a motion to dismiss a securities fraud complaint, and stated that pursuant to "proper recognition of the limits of the doctrine of fraud by hindsight" courts should draw inferences "favorable to plaintiff[s]" at the pleadings stage. *Id.* at 90.

RAIT and its senior executives also contend that the Complaint fails to sufficiently allege their "scienter" pursuant to the Private Securities Litigation Reform Act of 1995 (the "PSLRA"). This argument fails. The Complaint alleges numerous facts showing that these Defendants—Betsy Cohen (RAIT's Chairwoman and CEO), Daniel Cohen (RAIT's CEO) and Jack Salmon (RAIT's CFO)—had intimate knowledge of RAIT's credit portfolio. Moreover, they had especially powerful motives to commit fraud—motives that are unique to this case and will rarely be found with other public companies. These well-pled allegations (discussed in detail below) readily satisfy the requirements for pleading scienter under *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499 (2007). Indeed, in factual circumstances very similar to those alleged here, the United States Court of Appeals for the Eighth Circuit rejected many of the same arguments Defendants make in this case, and sustained a securities fraud class action asserted against a real estate finance company similar to RAIT. *See Florida State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645 (8th Cir. 2001).

Grant Thornton and the Trustee Defendants seem to acknowledge the strength of the allegations against RAIT and its management, but contend that they (Grant Thornton and the Trustee Defendants) should be dismissed from this "potentially massive securities fraud action" because they are "peripheral player[s]." *See* GT Mem. at 2; Tr. Mem. at 3-4. Indeed, the Trustee Defendants blame RAIT's management and Grant Thornton for the fraud, claiming "it was RAIT's management, not the Outside Trustee Defendants, [who] bore the responsibility to ensure RAIT's financial statements and disclosures were complete [and] . . . Grant Thornton, not the Outside Trustees, that was charged with conducting the audit of RAIT's financial statements." Tr. Mem. at 13; *see* GT Mem. at 3-4.

This finger pointing by Defendants is unavailing (though it speaks volumes about the well-pled allegations against RAIT and its senior executives). Grant Thornton, the Trustee Defendants and the Underwriter Defendants are not charged with fraud. The claims against them are strict liability and negligence claims brought pursuant to the Securities Act of 1933 (the "Securities Act"). As the Supreme Court has recognized, these claims "place[] a relatively minimal burden on a plaintiff." *Herman & MacLean v. Huddlestorm*, 459 U.S. 375, 381-82 (1983). The Complaint alleges in detail that these Defendants were negligent in failing to ensure that statements made in RAIT's public filings were complete and accurate. Thus, the Complaint readily satisfies the pleading standards for Securities Act claims. *Tellabs*, 127 S. Ct. at 2507 (noting that for non-fraud claims "the complaint must say enough to give the defendant 'fair notice of what the plaintiff's claim is and the grounds upon which it rests.'").

FACTUAL OVERVIEW

An overview of the Complaint's factual allegations is set forth below. To the extent additional factual allegations in the Complaint are relevant to Defendants' motions to dismiss, they are discussed in the Argument section below.[3]

[3] The Defendants in this case are RAIT Financial Trust f/k/a RAIT Investment Trust ("RAIT" or the "Company"), Betsy Z. Cohen ("Betsy Cohen"), Daniel G. Cohen ("Daniel Cohen") and Jack E. Salmon ("Salmon") (collectively, the "Section 10(b) Defendants"); Ellen J. DiStefano ("DiStefano"); Grant Thornton LLP ("Grant Thornton"); Edward S. Brown ("Brown"), Frank A. Farnesi ("Farnesi"), S. Kristin Kim ("Kim"), Arthur Makadon ("Makadon"), Daniel Promislo ("Promislo"), John F. Quigley III ("Quigley"), and Murray Stempel III ("Stempel") (collectively, the "Trustee Defendants"); Friedman, Billings, Ramsey Group, Inc. and FBR Capital Markets Corp. (together, "FBR"), Bear, Stearns, & Co. Inc. ("Bear Stearns"), UBS Securities LLC ("UBS"), RBC Capital Markets Corp. ("RBC Capital"), KeyBanc Capital Markets ("KeyBanc"), Stifel, Nicolaus & Company ("Stifel Nicolaus"), BMO Capital Markets Corp. ("BMO"), Piper Jaffray & Co. ("Piper Jaffray"), and RBC Dain Rauscher ("Dain Rauscher") (collectively, the "Underwriter Defendants").

A. Taberna's Business and Failed IPO

On April 28, 2005, Cohen Brothers, LLC ("Cohen Bros."), an investment management firm founded by Daniel Cohen[4] and his brother Jonathan, formed Taberna Realty Finance Trust ("Taberna"). ¶74. In connection with this transaction, Cohen Bros. received approximately $20 million worth of Taberna stock and Daniel Cohen—who owned an 87% controlling interest in Cohen Bros.—became the CEO of Taberna. ¶¶74-75.

Taberna, a real estate finance company, assisted homebuilders, mortgage lenders and other real estate companies in issuing trust preferred securities ("TruPS") and other types of subordinated debt, which Taberna would then purchase from the real estate companies. ¶56. TruPS were a particularly attractive form of financing for these companies because TruPS did not require pledges of collateral and ranked junior to the issuers' existing debt obligations. ¶57. When Taberna had acquired a sufficiently large pool of TruPS and subordinated debt—usually between $600 million and $1 billion—it would package that debt into private securities referred to as collateralized debt obligations ("CDOs"). ¶¶57-58. The CDOs issued by Taberna generated income as long as the underlying collateral performed—*i.e.*, as long as the real estate companies that issued the TruPS and subordinated debt collateralizing the CDOs continued to make payments of interest and principle. ¶58.

Taberna's CDOs were divided into multiple tranches with differing levels of seniority. ¶59. The highest-rated tranches would be paid first and the lowest-rated would be paid last (and not at all if the underlying collateral did not perform well enough to pay each of the higher-rated tranches). ¶¶59-60. Taberna would sell the highest-rated tranches of its CDOs and retain the

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[4] Reports indicate that Daniel Cohen has recently moved out of this District and currently resides in Paris, France. That should have no impact on this Court's power over Mr. Cohen in the context of this ongoing case.

most junior, or "equity," portions for itself. ¶60. Because these retained equity interests—referred to as the "first loss" interests—were paid last, they were the first to suffer an impairment if the real estate companies underlying the CDOs were unable satisfy any portion of their payment obligations. *Id.*

Taberna was in a capital-intensive business and needed hundreds of millions of dollars in order to purchase the TruPS and subordinated debt necessary to originate each of its CDOs. ¶61. In November 2005, in an effort to ensure that it had access to sufficient capital, Taberna filed a Form S-11 with the SEC seeking to register securities for an initial public offering ("IPO"). ¶62. The IPO was intended to raise funds that Taberna could use to originate new CDOs, and also to make Taberna a publicly-traded company so that it would have the ability to raise additional capital from the public securities markets in the future. ¶61.

By November 2005, however, the previously booming real estate markets, and particularly the subprime mortgage, Alt-A mortgage and homebuilder markets in which Taberna operated, were deteriorating. ¶62. These declining market conditions derailed Taberna's IPO. *Id.* Indeed, in a document filed with the SEC in November 2006, Taberna admitted that by April 2006, the "execution risks" associated with an IPO were too great. In reality, the IPO failed because of the severe problems throughout the real estate industry. ¶62.

B. RAIT Agrees To Merge With Taberna And Assumes Taberna's Exposure To Conditions In The Real Estate Industry And Specific Troubled Borrowers

Taberna's failed IPO created a serious problem for the company. Without access to the capital available to a publicly-traded company—*i.e.*, investors' money—Taberna was unable to originate additional CDOs and risked becoming a static collection of fixed-income assets with no growth potential. *Id.*; *see also* ¶61 (RAIT acknowledged in an SEC filing that "Taberna's business requires a significant amount of cash" and without access to such cash "the business and financial performance of RAIT . . . will be significantly harmed”). To solve this problem, Daniel Cohen enlisted an outside investment bank to identify a public company as a merger partner. ¶63. As Defendants have since admitted, however, no independent public company was interested in merging with Taberna (which, as discussed above, had experienced a failed IPO and faced rapidly deteriorating conditions in its industry). ¶64.

On June 8, 2006, the first day of the Class Period, Betsy Cohen announced that she had agreed to merge her publicly-traded real estate investment trust (RAIT) with her son’s company (Taberna). ¶63. In an effort to convince investors that the deteriorating market conditions that had undermined Taberna’s IPO should not concern them, Daniel and Betsy Cohen portrayed Taberna as a company that maintained extremely strong credit and financed only the highest-quality real estate companies. ¶67. For instance, on a conference call with investors on June 9, 2006, Daniel Cohen stated that “the most important element” of the merger was that Taberna had “no risks in terms of our underlying finance structure.” ¶68 (emphasis added). Expanding on this theme, he told investors that Taberna “finance[d] the best and most capable, best capitalized real estate borrowers” and that Taberna did “a cream of the crop approach to lending to real estate investment trusts and real estate operating companies.” ¶70 (emphasis added). Daniel and Betsey Cohen also distributed a slide presentation touting Taberna’s supposed “focus on low-risk asset classes” and “disciplined underwriting policies and procedures.” ¶71. In response to these and similar statements, RAIT’s common shares rose in price from $25.16 on June 8, 2006 to $27.23 by June 12, 2006. ¶67.

The merger with Taberna fundamentally altered RAIT’s business model and risk profile. Prior to the Class Period, RAIT was a real estate investment trust focused on acquiring and managing a wide variety of traditional real estate interests. ¶56. Following the merger, RAIT began to focus predominantly on Taberna's CDO origination and real estate financing business. ¶¶56-60.

In connection with the merger, RAIT also acquired the "first-loss" interests on six CDO's that were previously issued by Taberna (referred to as "Taberna II through VII"). ¶80. Throughout the Class Period, however, RAIT refused to disclose to public investors the names of the specific real estate companies that had issued the TruPS and other subordinated debt underlying these CDOs. ¶81. Rather, Daniel Cohen claimed that RAIT had access to "inside information" about these "cream of the crop" companies which supposedly precluded RAIT from disclosing its TruPS counterparties. ¶¶70, 297. Thus, investors were unable to make an independent assessment of the financial condition of RAIT's borrowers, or to assess RAIT's exposure to declining real estate markets, and were forced instead to rely on Defendants' (false and misleading) statements regarding RAIT's credit exposure and financial results. *See, e.g.*, ¶¶2, 81, 94, 297.

During the Class Period, Defendants repeatedly assured investors that RAIT closely monitored its exposure to conditions in the real estate industry. *See* ¶¶3, 125, 131-32, 250, 256, 275. For example, Defendants told investors that RAIT engaged in an "intensive" and "continuous" credit monitoring process to ensure that its borrowers were in sound financial condition. ¶¶116, 131-32, 297. Defendants touted their "active risk management" procedures that were supposedly designed to identify and expose credit risks well in advance of a default. Defendants stated in public filings that RAIT "continually monitor[s] our assets for potential credit impairment" and described these procedures as including "ongoing surveillance" involving "detailed credit analysis." ¶¶131-32. In its Form 10-K for the fiscal year 2006, RAIT stated that its credit surveillance analysts "may communicate directly with our borrowers on a regular basis, visit properties, review public filings and reports generated by borrowers and review other sources of data that may impact a particular credit." ¶132. Recognizing that in the deteriorated real estate markets, investors were particularly concerned about potentially troubled borrowers, RAIT emphasized that it "will do so [evaluate credit exposure] even more closely for borrowers who are on one of our watch lists." *Id.*

Despite these positive statements, and unbeknownst to investors, by merging with Taberna, RAIT had acquired substantial exposure to homebuilders, subprime and Alt-A mortgage lenders, and other companies that were experiencing sharp declines as result of the downturn in the real estate markets. *See* ¶¶82-83.[5] As discussed below and alleged in the Complaint, when the truth about RAIT's exposure was finally revealed at the end of the Class Period, analysts covering the Company described the Taberna merger as creating a "toxic situation" that had never been disclosed to RAIT's investors. ¶81; *see also* ¶297.

C. Unbeknownst To Investors, The Deepening Crisis In The Real Estate Industry Exposes RAIT to Significant Credit Risk Throughout 2006

Between June 8, 2006, the date that the merger with Taberna was announced, and December 2006, when the merger closed, the real estate markets continued to experience sharp declines. ¶82. By July 2006, the Dow Jones U.S. Home Construction Index was down by 35%

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[5] As alleged in the Complaint, Taberna II through VII included exposure to at least the following: (i) a substantial portion of $103 million in TruPS from Beazer Homes USA ("Beazer"), a homebuilder and subprime lender; (ii) a substantial portion of $75 million in TruPS from Orleans Homebuilders Inc. ("Orleans"), a homebuilder; (iii) $45 million in TruPS from New York Mortgage Trust ("New York Mortgage"), a prime and subprime lender; (iv) $26 million in TruPS from Impac Mortgage Holdings ("Impac"), an investor in subprime and Alt-A loans; (v) $25 million in TruPS from NovaStar Financial Inc. ("NovaStar"), a subprime lender; (vi) $25 million in TruPS from WCI Communities, Inc. ("WCI"), a homebuilder; (vii) $20 million in TruPS from Hanover Capital Mortgage Holdings ("Hanover"), a specialty finance REIT; (viii) TruPS from Tarragon Corporation ("Tarragon"), a homebuilder, in an amount currently unknown; (ix) TruPS from Levitt Corporation ("Levitt"), a homebuilder, in an amount currently unknown; (x) TruPS from HomeBanc Corp. ("HomeBanc"), a subprime lender, in an amount currently unknown; and (xi) TruPS from Great Wolf Resorts, Inc. ("Great Wolf"), a real estate company, in an amount currently unknown. ¶94.

and continued to decline throughout the year. When DR Horton Inc., the nation's largest homebuilder, cut its earnings forecast by 33% in July 2006, an industry analyst stated "this is an industry epidemic, and we believe others could get hit worse." *See id.* (detailing declines in the homebuilder market in the summer and fall of 2006). By November 2006, the sharp deterioration in the real estate markets had led to the collapse of number of subprime and Alt-A lenders. *See* ¶83 (detailing liquidations and termination of several mortgage lenders).

In addition, and unbeknownst to investors, an ever-increasing number of TruPS borrowers that collateralized RAIT's CDOs had begun to experience significant problems. As alleged in the Complaint—and not contested by Defendants—Lead Counsel's investigation has revealed that Taberna II through VII contained significant exposure to TruPS issued by several subprime-related and homebuilder companies that were in serious trouble in 2006, including:

- <u>American Home Mortgage</u>. RAIT had at least $95 million in exposure to TruPS issued by American Home Mortgage ("AHM"), an originator of Alt-A loans. As of September 30, 2006, AHM had short-term obligations in excess of its liquid assets. As noted below, AHM reported this same capital shortfall for the quarters ended December 31, 2006, March 31, 2007, and June 30, 2007. ¶¶94, 309(h).

- <u>Orleans Homebuilders Inc.</u> RAIT had at least $75 million in exposure to TruPS from Orleans Homebuilders Inc. ("Orleans"), a homebuilder. Orleans had approximately $30 million of available liquid assets versus more than $80 million of short-term obligations, and had experienced a 50% decline in its net income from the same period in the prior year. Orleans also stated that its "future revenues, gross margins and net income" would be "further reduc[ed]" going forward. ¶¶94, 102, 309(f).

- <u>WCI Communities, Inc.</u> RAIT had at least $25 million in exposure to TruPS from WCI Communities, Inc. ("WCI"), a homebuilder. In August of 2006, WCI announced a 70% decline in net income for the 2006 second quarter and liquidity that had deteriorated from $52.6 million at December 31, 2005 to just $2.0 million as of June 30, 2006. As of the third quarter of 2006, WCI's current obligations exceeded its available liquid assets. ¶¶94, 100, 309(a).

- <u>New York Mortgage Trust</u>. RAIT had at least $45 million in exposure to TruPS from New York Mortgage Trust ("New York Mortgage"), a subprime and prime lender. In March of 2006, New York Mortgage announced a net loss of $8.7 million for the 2005 fourth quarter, and a net loss of $5.3 million for all of 2005.

In May of 2006, the company announced that its liquid assets were barely equal to its short-term obligations. ¶¶94, 97, 309(e)

- Tarragon Corporation. RAIT had exposure to TruPS from Tarragon Corporation ("Tarragon"), a homebuilder, in an amount currently unknown. In October of 2006, Fitch Ratings placed certain Tarragon TruPS on "rating watch negative," meaning that they could soon be downgraded to junk bond status. In November of 2006, Tarragon reported that its short-term obligations exceeded current liquid assets by more than $40 million. Tarragon also reported a 71.5% decline in new orders during the 2006 third quarter, and a 71.4% drop in new home deliveries for the same period. ¶¶103, 309(c).

- Levitt Corporation. RAIT had exposure to TruPS from Levitt Corporation ("Levitt"), a homebuilder, in an amount currently unknown. In August of 2006, Levitt announced that its profits had declined 104% through the six months ended June 30, 2006, as compared to the same period in the prior year. Levitt announced that net income through the nine months ended September 30, 2006 had declined by more than 96% as compared to the same period in 2005 and that its current obligations were twice as large as its liquid assets. ¶¶101, 309(d).

RAIT had significant exposure to the "first loss" tranches of CDOs collateralized by numerous additional TruPS borrowers who had serious problems throughout 2006.[6] *See* ¶¶94-105.

D. Defendants Mislead Investors About RAIT's Credit Exposure And Raise $390 Million From Public Investors In The January 2007 Stock Offering

By mid-2006, the collapse of the residential mortgage market was apparent to those who were directly involved in the industry. For example, Goldman Sachs Group was accumulating

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[6] The identities of additional TruPS borrowers in RAIT's portfolio is information peculiarly in the possession of Defendants (and with the exception of AHM, Defendants have never disclosed the names of these companies). While Defendants do not dispute that Lead Counsel's investigation has correctly identified twelve of their TruPS borrowers, there are almost certainly other subprime, homebuilder and Alt-A companies that were included in RAIT's portfolio during the Class Period that will not be identified until discovery. *See* ¶94 ("This information is peculiarly in the possession and control of RAIT and other Defendants and Lead Plaintiff expects that discovery will yield additional information regarding the identity of other troubled companies in RAIT's portfolio, and the amount of exposure that RAIT had to each such company."). It is for this reason that the Third Circuit has held that "[w]here it can be shown that the requisite factual information is peculiarly within the defendant's knowledge or control, the rigid requirements of Rule 9(b) may be relaxed." *In re Rockefeller Ctr. Props., Inc. Sec. Litig.*, 311 F.3d 198, 216 (3d Cir. 2002). *See also EP Medsystems, Inc. v. EchoCath, Inc.*, 235 F.3d 865, 882 (3d Cir. 2000) ("It is difficult to see how [plaintiff] could have pled fraud or scienter with more specificity without having been given the opportunity to conduct any discovery [because] the necessary information . . . lies in the defendants hands.").

short positions by betting that the values of CDOs backed by residential mortgage debt would fall. ¶84. These problems were well known within RAIT as well. As alleged in the Complaint, the public disclosures of financial trouble by so many of RAIT's TruPS borrowers should have alerted RAIT's insiders to the fact that the Company's TruPS portfolio was impaired. Indeed, according to a former Senior Vice President of Origination at RAIT ("CW1"), in light of Taberna's substantial exposure to homebuilders in its TruPS portfolio, "the biggest, most glaring problem" with the merger was the failure to account for the increased risk that Taberna's portfolio brought to RAIT. ¶104. CW1 also stated that there was ample evidence by August 2006 that the homebuilder's market was tanking and it was well-known within RAIT that the subprime and Alt-A markets were "a disaster." *Id.* Similarly, a former Vice President of Investment Banking in the Asset Backed Securities and Specialty Finance Departments of Defendant FBR ("CW2") confirmed that there was long-standing knowledge in the industry that the CDO market was "a ticking time bomb." *Id.*

In December 2006, despite Defendants' knowledge of the serious problems facing the particular companies underlying the Company's TruPS portfolio, the merger between RAIT and Taberna closed. On a November 3, 2006 conference call, a RAIT executive described Taberna as a "stable business," and when Betsy Cohen was asked about Taberna's exposure to the residential marketplace, she replied by stating that "<u>it's totally hedged out</u>." ¶85. In other words, Betsy Cohen was falsely telling investors that Taberna faced no credit exposure whatsoever to the declining conditions in the real estate markets. Betsy Cohen's statements were bolstered by RAIT's Joint Proxy statement, which was mailed to investors on or about November 7, 2006, and stated that "RAIT has an exemplary track record of credit analysis and underwriting, having suffered almost no losses during its history." ¶87. The Joint Proxy also stated that Taberna had a loan loss provision of only $1.1 million, which, when compared to Taberna's $3.3 billion TruPS portfolio, misleadingly suggested that Taberna had extremely limited potential exposure to the deepening real estate crisis. ¶89. Defendants' misleading statements had their intended effect. Notwithstanding the widespread problems in the real estate industry, the price of RAIT's common stock climbed from $25.16 on June 6, 2006 (the date of the merger announcement) to $34.37 on December 11, 2006 (the day the merger closed). ¶93.

On January 24, 2007, Defendants benefited from the artificial inflation they had created in RAIT's stock price by conducting a secondary offering of 11.5 million shares of the Company's common stock at a price of $34 per share—raising more than $390 million from investors. ¶¶112-20. The January 2007 Stock Offering was conducted pursuant to the January 2007 Registration Statement (as defined in ¶113 of the Complaint), which was signed by Defendants Betsy Cohen, Daniel Cohen, Salmon, DiStefano, Brown, Farnesi, Kim, Makadon, Pomislo, Quigley, and Stemple, and underwritten by the Common Stock Underwriter Defendants (as defined in ¶41 of the Complaint). ¶113. The proceeds from the January 2007 Stock Offering were used to pay down the Company's credit facilities and to purchase additional TruPS in order to fuel the Company's CDO origination business. ¶114. The only reason that the January 2007 Stock Offering was able to go forward was because Defendants actively mislead investors regarding RAIT's exposure to declining credit markets.[7] *See* ¶120.

[7] For instance, on January 23, 2007—the day before the January 2007 Stock Offering closed—WCI announced that it was experiencing an extremely high level of defaults, and was "recording significant impairments and write-offs." ¶107. (As detailed in the Complaint, RAIT's investors were never told that RAIT had at least $25 million in exposure to "first loss" equity tranches collateralized by WCI's TruPS.) *See* ¶¶2, 81, 94, 297.

E. Daniel Cohen Falsely States That RAIT's Potential Exposure To The Market Meltdown Is "Less Than $13 Million" And "De Minimis"

The problems in the real estate industry continued unabated during the first months of 2007. For example, in late January 2007, Orleans announced that it had violated its debt service ratio covenants governing approximately $502 million of borrowings and $41 million of letters of credit. ¶¶108, 309(f). This violation, Orleans announced, was an "event of default," for which its lenders could demand immediate and full payment of Orleans' $543 million in debt. *Id.* Like Orleans, numerous other companies that had purchased RAIT's TruPS also experienced additional significant negative events, including:

- Levitt announced that as of December 31, 2006, it suffered a net loss of $9.2 million and its short-term obligations exceeded its liquid assets by more than $100 million. ¶¶109, 309(d). Levitt acknowledged that "these conditions have a negative impact on our liquidity." ¶309(d).

- NovaStar announced a net loss for the 2006 fourth quarter of $14.4 million, a decline of 155% from the year-ago period. NovaStar's CFO stated that between 2007 and 2011, NovaStar "expects to recognize little, if any, taxable income." ¶236.

- WCI reported a net loss for the 2006 fourth quarter of $64.5 million—a decline of 218% from the year-ago period. ¶237.

- Impac announced a net loss of $54 million for the 2006 fourth quarter—a 250% decline from the year-ago period. Impac also announced a net loss of $81 million for the entire year 2006. ¶238.

- AHM reported short-term obligations in excess of its liquid assets as of December 31, 2006. ¶309(h).

In addition, during February 2007, seven separate subprime lenders either terminated operations or filed for bankruptcy. *See* ¶243.

On February 22, 2007, RAIT held a conference call to discuss the Company's fourth quarter results. One analyst asked Daniel Cohen to "comment on the seasoning and vintage of your credit." Daniel Cohen replied that RAIT "will take a conservative stance toward credit losses going forward" (¶249), and had the following exchange with another analyst:

> **[Analyst]:** A couple of questions, I think. First, just on the subprime mortgage space, what do you have within your TruPS portfolio, do you have some exposure there? What exposure do you have throughout RAIT to subprime mortgage, and what concerns do you have over that exposure?
>
> **Daniel Cohen:** Our exposure on the asset side is less, is in the single basis point. So, our exposure in a dollar amount is less than $13 million across the whole entire portfolio. So we don't really have any exposure to the subprime nonconforming lending space. Did that answer the question?
>
> **[Analyst]:** Yes, I think so. I wasn't sure if you had some TruPS out with some – with one or two of the subprime mortgage REITs or not, and apparently you don't.
>
> **Daniel Cohen:** The $12.5 [million] is the net exposure to one REIT that we continue to monitor but feel very comfortable about. And it's a de minimis exposure overall.

¶250.

Daniel Cohen's statements were false. As Daniel Cohen knew at the time, RAIT had at least between $96 million and $199 million in exposure to several subprime mortgage companies, including Beazer, New York Mortgage, NovaStar, Impac, and HomeBanc. ¶251. This false statement was particularly material to investors who were concerned that RAIT would become another casualty of the lengthy real estate crisis. By falsely assuring investors in response to a direct question that RAIT had a "de minimis" $13 million exposure "across the whole entire portfolio," Daniel Cohen ensured that investors would not learn the truth about RAIT's financial condition and credit exposure.

F. Defendants Continue To Misrepresent RAIT's Credit Exposure While RAIT Raises An Additional $465 Million From Investors

As detailed in the Complaint, numerous mortgage lenders and other real estate companies filed for bankruptcy or otherwise ceased operations in February 2007 (¶243), with even more failing in March 2007 (¶¶253-54) and April 2007 (¶266). By May 1, 2007, approximately forty-two mortgage lenders, homebuilders and other real estate companies had failed due to the devastating conditions impacting the industry. *See* ¶¶243, 253-55, 266. Unbeknownst to investors, and contrary to Daniel Cohen's statement that RAIT only financed "cream of the crop" companies, these conditions also impacted the particular TruPS borrowers underlying the "first loss" interests to which RAIT was exposed. The Complaint sets forth detailed allegations regarding the impact that declining market conditions were having on RAIT's specific TruPS borrowers, including:

- AHM. On March 1, 2007, AHM announced that it had $124.3 million in loans that were in default. ¶252. On April 6, 2007, AHM disclosed that "our working assumption must be that current market conditions will persist and that [the company's results] will not recover through the balance of the year." ¶261. AHM also disclosed that "high delinquency related charges" were causing the company to establish "additional reserves for increases in non-performing loans." ¶262.

- Novastar. On March 14, 2007, NovaStar announced that it was laying off 350 employees, approximately 17% of its workforce. On April 5, 2007, NovaStar shuttered its mortgage lending business. ¶252.

- Beazer. On March 25, 2007, the Charlotte Observer reported that the Federal Bureau of Investigation, the Internal Revenue Service, and the Department of Justice jointly had opened "a broad criminal probe of [Beazer's] lending practices, a number of financial transactions, and other matters." ¶252.

- Levitt. Levitt announced a net loss as of December 31, 2006 of $10.7 million, a decline of 238% as compared to the prior year. ¶252.

- Tarragon. Tarragon reported a net loss of $25.1 million as of December 31, 2006. It once again reported that its short-term obligations exceeded its current liquid assets by more than $40 million. ¶252.

See also ¶¶234-41, 252 (setting forth additional examples of the negative financial condition of RAIT's TruPS borrowers).

By mid-March 2007, the situation was so dire that Defendant FBR itself was attempting to divest its wholesale subprime lending unit, which had originated $4 billion in subprime loans in 2005 but was suffering heavy losses in the wake of then-prevailing market conditions. ¶255. On March 30, 2007, FBR's lending unit closed its doors and Defendant FBR took a restructuring charge of $41.3 million. ¶255.

Defendants, however, continued to misrepresent RAIT's exposure to these conditions as they prepared to raise more than $400 million from investors. Consistent with its previous statements regarding RAIT's "cream of the crop" approach to financing real estate companies and its "de minimis" exposure that was "totally hedged out," RAIT continued to market itself to investors as being safely above the turmoil going on in the marketplace at large. For instance, on March 20, 2007, RAIT gave a presentation at Cohen & Company's investor conference, where Defendants Betsy Cohen, Daniel Cohen and Jack Salmon presented a slide presentation that was also attached to a Form 8-K filed with the SEC. ¶256. The slide presentation repeated Defendants' previous false statements regarding RAIT's supposed "credit focus" and "risk monitoring and surveillance," as well as making false statements regarding RAIT's financial condition (detailed below). ¶¶256-57. As a result, RAIT's stock price rose from $28.60 on March 19, 2007 to $30.84 on March 22, 2007. ¶258.

On March 29, 2007, RAIT closed on another CDO, Taberna VIII, Ltd., a $772 million CDO that included a substantial "first loss" piece retained by RAIT. ¶259. As the real estate market continued to decline and the particular TruPS borrowers underlying RAIT's CDOs suffered additional financial distress (*see* ¶¶260-66), RAIT issued $425 million of 6.875% Convertible Senior Notes in a private offering (as defined in ¶121 of the Complaint, the "April 2007 Note Offering"). ¶267. RAIT used $74 million of the proceeds it received from the April 2007 Note Offering to buy back more than 2.7 million shares of its common stock and the remaining proceeds to fund its CDO origination business. ¶268.

On May 1, 2007, RAIT held a conference call to discuss its results of operations for the second quarter 2007. ¶272. On that call, Defendants made a number of false statements regarding RAIT's exposure to troubled and impaired companies. ¶¶272-75. For instance, Daniel Cohen stated (just as he had in February) that "on the credit side, we had no payment defaults from our TruPS corporate issuers. However, we continue to take a conservative view by providing for loan losses in our residential [portfolio] as the overall balance sheet continues to grow." *Id.* Betsy Cohen stated "as Daniel has described to you, RAIT has both corporate and real estate-specific lines of lending. Both of these markets are healthy today." ¶274 (emphasis added). The very first question from an analyst concerned RAIT's potential exposure to the subprime and homebuilder markets, to which Daniel Cohen responded:

> **Daniel Cohen**: Bob, as to our subprime exposure we have very, very limited subprime exposure and we believe that we are currently not at risk for any losses there. The total amount net is just less than $13 million and it's relatively immaterial to our balance sheet overall. As to the homebuilders, we are constantly looking over all of the companies that we lend to and again, we feel very strongly that our exposure there is amply covered and that we don't expect any losses in that sector.
>
> **Betsy Cohen**: Underscore the fact that we don't expect any losses in this sector, . . . we watch these carefully, as Daniel said.

¶275. As Daniel Cohen and Betsy Cohen knew, these statements were false. The Complaint alleges that, at that time, RAIT had at least $236 million in exposure to the sector of impaired subprime-related companies and homebuilders (indeed, RAIT later acknowledged this exposure). This exposure was comprised of, among others, $45 million in TruPS from New York Mortgage; $26 million TruPS from Impac; $25 million in TruPS from NovaStar; $25 million in TruPS from WCI; $20 million in TruPS from Hanover; and $95 million in TruPS from AHM. Further, RAIT had additional exposure to a substantial portion of $103 million in TruPS from homebuilders Beazer, a substantial portion of $75 million in TruPS from Orleans, and TruPS from Tarragon, Levitt, and HomeBanc. ¶94. Moreover, RAIT did not "watch these [companies] carefully." Rather, RAIT was not monitoring its credit exposure in any meaningful way whatsoever.

From May through July of 2007, RAIT's TruPS borrowers continued to decline, as did the subprime and homebuilder markets generally.[8] *See* ¶¶272-90. But instead of disclosing RAIT's worsening exposure—or at least disclosing that the Company's exposure was far more than the $13 million Daniel Cohen and Betsy Cohen had so recently represented—Defendants embarked on yet another public offering. On or about July 5, 2007, RAIT issued approximately 1.6 million shares of Series C Preferred Stock at $25 per share, raising approximately $40 million (as defined in ¶5 of the Complaint, the "July 2007 Preferred Stock Offering"). This offering was conducted pursuant to the July 2007 Registration Statement (as defined in ¶124 of the Complaint), which contained numerous false and misleading statements. *See* ¶¶125-39.[9]

G. <u>The Truth Begins To Emerge</u>

On July 31, 2007—just eighteen business days after closing on the July 2007 Preferred Stock Offering—RAIT finally disclosed its exposure to AHM, one of its impaired borrowers. But by that point, AHM already had defaulted on $95 million worth of debt it owed to RAIT. As a result of that disclosure, on July 31, 2007, RAIT's common stock plummeted over 36% from its opening price of $16.20 per share to close at $10.36 per share, on extraordinarily high volume of 21,911,400 shares (as compared to volume on the prior day of 5,832,000 shares). ¶292.

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[8] For example, from May through July 2007, twelve large subprime lenders filed for bankruptcy or otherwise ceased operations. ¶¶280-88. Moreover, many of the TruPS borrowers underlying RAIT's CDO portfolio continued to decline. *See also* ¶¶ 235-41, 252, 261-65, 277-79, 283-87, 309.

[9] The July 2007 Registration Statement also expressly incorporated RAIT's Form 10-K for fiscal year 2006, Grant Thornton's unqualified audit opinion for that Form 10-K, and RAIT's Form 10-Q for the quarter ended March 31, 2007. ¶127. As discussed below, both the 2006 Form 10-K and the 2007 first quarter Form 10-Q materially overstated the value of RAIT's TruPS portfolio and the Company's income. ¶¶147-50.

Analysts covering RAIT were shocked that RAIT had $95 million worth of exposure to a company such as AHM—particularly in light of Defendants' numerous false statements in this regard. One analyst stated that "given management's recent assurances and subsequent value erosion, investors should be prepared for anything." ¶295.

On August 1, 2007, TheStreet.com reported that RAIT faced enormous previously undisclosed "exposure to the plummeting real estate market" through a range of subprime lenders and homebuilders who were experiencing serious liquidity problems. ¶293. On August 2, 2007, RAIT held a conference call to discuss its second quarter 2007 earnings and its (newly disclosed) exposure to troubled and impaired debt. ¶296. On that call, Daniel Cohen disclosed for the first time that RAIT had a total of $377 million in "homebuilder and mortgage exposure" underlying Taberna II through VII. ¶ 296. Nonetheless, Daniel Cohen persisted in refusing to name any of the borrowers in RAIT's portfolio. He also refused to re-value RAIT's admittedly impaired TruPS portfolio—which was the Company's largest asset—until the "end of the quarter," *i.e.*, the end of September. *Id.* He then engaged in the following exchange with an analyst:

> **[Analyst]:** Yes, thank you for taking my call. I guess the first thing that comes to mind for me is the John McEnroe quote, "You can't be serious, here." At the end of Q-2, clearly the market for CMBS [commercial mortgage backed securities], looking at the CMBX [Commercial Mortgage Backed Securities Index], looking at anecdotal and specific bond transactions, had widened dramatically. Yet you just said you are going to look at the mark at the end of the quarter, just like you did last quarter. You didn't mark anything the last quarter. You thought at the end of Q-2 that everything was fine? In the homebuilders, with WCI, with Beazer, with Tarragon, you thought it was fine with the sub- and mid-prime mortgage lenders? What am I missing?
>
> **Daniel Cohen:** We have—our mark-to-market is done on an entire portfolio basis. There was negative credit migration among some borrowers and positive credit migration on others.
>
> **[Analyst]:** Is it done on a granular level or portfolio level Daniel?

Daniel Cohen: It is done on a granular level and then it is rolled up to a portfolio basis, and therefore –

[Analyst]: If it's done on a granular level, how can you say those homebuilders were fine? How is Tarragon good?

Daniel Cohen: I'm saying that there were offsets inside the entire portfolio, and I'm not addressing –

[Analyst]: <u>But you are taking the first loss piece. It doesn't matter what the best things do. It matters what the worst stuff does</u>.

¶298.

Following the August 2, 2007 conference call, <u>TheStreet.com</u> reported that "RAIT Financial Trust's (RAS) latest earnings release seems to be written by attorneys who have mastered the art of selective disclosure. That's because in reading between the lines, numerous questions remain about the company's exposure to collateralized debt obligations tied to the plummeting housing market." ¶¶99, 300. Likewise, on August 3, 2007, one analyst wrote that "RAIT's conference call left a number of questions about potential worst-case scenarios." ¶302. This analyst concluded that RAIT would lose "significant value in some of their CDOs—a likely scenario given the toxic credits that [RAIT] is exposed to [and that impairment] will likely take RAIT out of the CDO securitization game for a long time [and] essentially reduce the company to a static pool of assets." ¶302.

These disclosures revealed for the first time the true extent of RAIT's exposure to troubled and impaired real estate companies—the "toxic credits" recognized immediately by analysts, ¶¶287, 302, (even though RAIT's insiders had known of this exposure throughout the Class Period). In response to these disclosures, RAIT's stock plummeted from an opening price of $16.20 on July 31, 2007 to a closing price of $6.32 on August 3, 2007—a decline of approximately 61%.[10] ¶303.

ARGUMENT

Resolution of a Rule 12(b)(6) motion requires the Court to "accept as true all allegations in the complaint and all reasonable inferences that can be drawn therefrom, and view them in the light most favorable to the non-moving party." *DeBenedictis v. Merrill Lynch & Co.*, 492 F.3d 209, 215 (3d Cir. 2007). The court may dismiss the complaint "only if it appears certain that plaintiffs can prove no set of facts entitling them to relief." *In re Westinghouse Sec. Litig.*, 90 F.3d 696, 706 (3d Cir. 1996) (Alito, J.).

In this case, the Complaint asserts fraud claims pursuant to Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act") and non-fraud claims pursuant to Sections 11, 12(a)(2) and 15 the Securities Act of 1933 (the "Securities Act"). Lead Plaintiff's fraud claims pursuant to the Exchange Act are governed by the pleading requirements of the Private Securities Litigation Reform Act of 1995 (the "PSLRA"). In *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499 (2007), the Supreme Court held that, when addressing motions to dismiss under the PSLRA, courts must accept the factual allegations in a complaint as true. 127 S. Ct. at 2509; *see also In re Suprema Specialties, Inc. Sec. Litig.*, 438 F.3d 256, 269 (3d Cir. 2006) (reversing district court and holding that dismissal of securities claims is appropriate "only if it appears certain that plaintiffs can prove no set of facts that would entitle them to relief"); *Weiner v. Quaker Oats Co.*, 129 F.3d 310, 315 (3d Cir. 1997) ("The Supreme

[10] On or about August 8, 2007, RAIT filed its Form 10-Q for the third quarter ended June 30, 2007. In that filing, RAIT reported an approximately $6.1 billion balance in investments in securities, *i.e.*, its TruPS portfolio. Remarkably, that valuation was essentially unchanged from RAIT's March 31, 2007 Form 10-Q—even though one of its TruPS issuers already had defaulted and several others, as described above, were in severe financial jeopardy. ¶304.

Court has had frequent occasion to observe that the fundamental purpose of the [Exchange Act] was to substitute a policy of full disclosure for the philosophy of *caveat emptor* . . . ." (internal citations omitted)).

Unlike the Exchange Act fraud claims, Lead Plaintiff's non-fraud claims pursuant to the Securities Act are subject only to the notice pleading requirements of Rule 8(a)(2). *See Tellabs*, 127 S. Ct. at 2507 (providing that for non-fraud claims "the complaint must say enough to give the defendant 'fair notice of what the plaintiff's claim is and the grounds upon which it rests'" (quoting *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 346 (2005)). For these claims, "liability against the issuer of a security is virtually absolute, even for innocent mistakes." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983) (emphasis added); *see also In re Suprema Specialties, Inc. Sec. Litig.*, 438 F.3d at 269 (noting that Sections 11 and 12(a)(2) are "virtually absolute liability provision[s]); *In re Cendant Corp. Sec. Litig.*, 109 F. Supp. 2d 225, 228 (D.N.J. 2000) (recognizing "the relatively minimal burden on a Section 11 plaintiff".).

As set forth below, the Complaint plainly states valid claims under both the Exchange Act and the Securities Act.

I. THE COMPLAINT STATES CLAIMS UNDER THE EXCHANGE ACT

The Complaint alleges a claim arising under Section 10(b) of the Exchange Act against Defendants RAIT, Daniel Cohen, Betsy Cohen and Jack Salmon (the "Section 10(b) Defendants") and a "control person" claim under Section 20(a) against Daniel Cohen, Betsy Cohen and Jack Salmon. *See, e.g.*, ¶¶403-09. The Section 10(b) Defendants move to dismiss the Section 10(b) claim asserted against them by arguing that the Complaint fails to adequately allege (1) that they made a false or misleading statement or omission during the Class Period, or (2) that they acted with "scienter," *i.e.*, that they acted knowingly or with a reckless disregard for the truth. *See* RAIT Mem. at 10-21, 23-26, 30-40. As discussed below, the Section 10(b)

Defendants' highly fact-based arguments ignore or distort the detailed allegations of the Complaint and are otherwise unavailing.

A. The Complaint Adequately Alleges That Each Section 10(b) Defendant Made Actionable False And Misleading Statements And Omissions

To assert a Section 10(b) claim, a complaint must allege, among other things, that a defendant made a misrepresentation or omission of a material fact. To satisfy this element, the PSLRA requires that a complaint "specify each statement alleged to have been misleading [and] the reason or reasons why the statement is misleading." 15 U.S.C. § 78u-4(b)(1)(B). The requirement that a Section 10(b) claim adequately identify the misrepresentations alleged to have been made by each defendant is not intended to place an exacting burden on plaintiffs, and a complaint that "identifies the circumstances of the alleged fraud so that defendants can prepare an answer" satisfies this requirement of the PSLRA. *Cooper v. Pickett*, 137 F.3d 616, 627 (9th Cir. 1997).

To plead a false statement, a complaint need only "identif[y] to whom each statement is attributable, what was said, when it was said, and demonstrate[] why it was misleading." *In re DVI, Inc. Sec. Litig.*, No. 03-5336, 2005 WL 1307959, at *10 (E.D. Pa. May 31, 2005) (Davis, J.); *see also Weiner*, 129 F.3d at 319 ("Our cases warn, however, that focusing exclusively on the particularity requirement is too narrow an approach and fails to take account of the general simplicity and flexibility contemplated by the rules"); *In re Immucor Inc. Sec. Litig.*, No. 1:05-CV-2276, 2006 WL 3000133 (N.D. Ga. Oct. 4, 2006) (reasoning that "Plaintiffs' allegations satisfy the heightened pleading requirements of the PSLRA" because they "identified nine specific statements and filings they allege to have been misleading . . . assert why they allege that the statement was misleading . . . [and] identify with specificity the time, date, and circumstances of each allegedly misleading statement"); *Montoya v. Mamma.com*, No. 05 Civ. 2313, 2006 WL

770573, at *4 (S.D.N.Y. Mar. 28, 2006) (plaintiff adequately pled misstatements because the complaint "identified each statement alleged to have been misleading and the reasons why" (internal quotation marks omitted)); *In re Cell Pathways, Inc.*, No. 99-725, 2000 WL 805221, at *9 (E.D. Pa. June 20, 2000) (complaint adequately alleged false statements because it set forth "what statements are alleged to be false, who made them and where, and why they were false"); *id.* at *9-10.

Here, the Section 10(b) Defendants argue that the Complaint must be dismissed because (1) it purportedly fails to allege that they made a single misstatement or omission regarding the Company's financial condition or purported compliance with GAAP during the Class Period; and (2) their alleged misstatements regarding the Company's credit underwriting process were not false when made or—even if they were false when made—were not material to investors. *See* RAIT Mem. at 10-15. As set forth below, these arguments lack merit.[11] As the Underwriter Defendants note, "almost half of the Complaint deals with allegedly fraudulent statements by RAIT Financial Trust." UW Mem. at 1. Moreover, the Section 10(b) Defendants do not dispute the material falsity of numerous alleged oral misrepresentations set forth in detail throughout the Complaint, including allegedly false statements they made regarding RAIT's supposed "de minimis" and only "$13 million" in exposure.

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[11] As a general matter, defendants' arguments that the Complaint fails to identify an actionable misstatement challenge the <u>substance</u> of Lead Plaintiff's allegations rather than the <u>existence</u> of those allegations. Courts routinely reject this approach on a motion to dismiss because, among other things, it would effectively force Lead Plaintiff to satisfy Rule 56 on a Rule 12 proceeding. *See In re ProQuest Sec. Litig.*, 527 F. Supp. 2d 728, 744 (E.D. Mich. 2007) ("[Defendant's] arguments really go to challenging the substance of the statements, not whether plaintiffs have actually plead that he made false statements. Plaintiffs have identified several statements which they say are false and are misrepresentations. The complaint is not subject to dismissal on these grounds."); *In re Cell Pathways, Inc.*, No. 99-725, 2000 WL 805221, at *8 (E.D. Pa. June 20, 2000) ("At this stage in the proceedings, once again, it would have been inappropriate for this Court to dismiss the Complaint based merely on [defendants'] vehement insistence on their version of contested issues in this case.").

1. The Section 10(b) Defendants Do Not Dispute The Material Falsity of Statements They Made On Conference Calls With Investors

The Section 10(b) Defendants do not, nor could they reasonably contend, that the Complaint fails to adequately allege the material falsity of the statements they made on conference calls with investors on June 9, 2006 (¶¶68-71),[12] November 3, 2006 (¶85),[13] February 22, 2007 (¶¶249-51),[14] and May 1, 2007 (¶¶272-76).[15] By failing to even mention these

[12] False statements made by Daniel Cohen on the June 9, 2006 joint RAIT-Taberna conference call with investors include, among other things, that there are "no risks in terms of our underlying finance structure;" "we really finance the best and most capable, best capitalized real estate borrowers;" and that RAIT would "really do a cream-of-the-crop approach to lending to real estate investment trusts and real estate operating companies." ¶¶68-70. In addition, the Section 10(b) Defendants distributed a slide presentation in connection with that conference call, falsely touting the combined company's "focus on low-risk asset classes" and "disciplined underwriting policies and procedures." ¶71.

[13] On the November 3, 2006 conference call Betsy Cohen falsely stated that Taberna's and thus RAIT's exposure to the entire "residential marketplace" was "totally hedged out," *i.e.*, non-existent. ¶85.

[14] In addition to the statements addressed above, Defendants made a number of other false and misleading statements on the February 22, 2007 conference call. Jack Salmon stated that RAIT earned "REIT taxable income of approximately $92.1 million" for 2006 and $30.8 million of such income for the 2006 fourth quarter. ¶349. These statements of income were false for the same reasons RAIT's other accounting statements were false, as set forth herein. Betsy Cohen falsely stated that, "we're so dedicated to pristine credit." ¶349. Daniel Cohen falsely stated that RAIT "will take a conservative stance toward credit losses going forward." ¶249. The Complaint alleges in detail—including by naming the specific companies—that RAIT had at least $236 million of exposure to impaired subprime-related companies and homebuilders (and RAIT eventually conceded it had $622 million in exposure). Concealing more than $223 of then existing credit to troubled companies is anything but "conservative," and Daniel Cohen's statement to the contrary was designed to mislead RAIT's investors. *See Shapiro*, 964 F.2d at 282 (holding that "where a defendant affirmatively characterizes management practices as 'adequate,' 'conservative,' 'cautious,' and the like, the subject is 'in play'" and the statements are actionable under the securities laws). Daniel Cohen also stated that RAIT had approximately $13 million in exposure to only "one REIT that we continue to monitor but feel very comfortable about," and that this exposure was "a de minimis exposure overall." ¶250.

[15] In addition to the statements described above, on the May 1, 2007 conference call Jack Salmon falsely stated that RAIT had earned $43 million in net investment income, and that the Company's "12.6 billion of investments are generating approximately a 15% return on investment or approximately $180 million of net investment income on a full year." ¶¶272-73. Jack Salmon also falsely stated several other accounting metrics, including the value of the Company's TruPS portfolio and net income available to common shares. ¶¶361-62. Daniel Cohen falsely stated that, "Our credit quality remains strong in our core business, even though the first quarter was perhaps the nadir of the mortgage financing business. We believe that market conditions are favorable for our businesses and we should continue to grow our portfolio substantially over the next few quarters . . . ." ¶272. Daniel Cohen further stated, falsely, that, we continue to take a conservative view by providing for loan losses in our residential [portfolio] as the overall balance sheet continues to grow." *Id.* Daniel Cohen also stated that the market for "CDOs . . .

statements in their motion to dismiss, the Section 10(b) Defendants have conceded that the Complaint adequately alleges that these statements were materially false and misleading when made. Indeed, given the plain falsity of these statements, there can be no reasonable argument to the contrary (and certainly not one that is consistent with accepting the allegations of the Complaint as true, as required on a motion to dismiss).

For instance, on the February 22, 2007 call, Daniel Cohen falsely stated that RAIT took a "conservative stance" towards credit exposure and that RAIT's exposure to subprime borrowers in its TruPS portfolio was "less than $13 million across the whole entire portfolio. So we don't really have any exposure to the subprime nonconforming lending space." ¶¶249-50. And Betsy Cohen stated, among other things, that RAIT was "so dedicated to pristine credit." ¶349. As alleged in the Complaint, "these statements were materially false and misleading, and were designed to mislead investors about the size and extent of RAIT's exposure to troubled real estate companies." ¶251; *see also id*. ("As Defendant Daniel Cohen knew at the time, RAIT had at least between $96 million and $199 million in exposure to several subprime mortgage companies, including Beazer Homes USA ('Beazer') (which extended subprime loans to purchasers of its homes), New York Mortgage, NovaStar, Impac and HomeBanc."). Thus, the Complaint adequately alleges that these statements were materially false and misleading.

In addition, the Complaint alleges that Daniel Cohen made nearly identical false and misleading statements on a conference call with investors on May 1, 2007, when he stated that:

> [W]e have very, very limited subprime exposure and we believe that we are currently not at risk for any losses there. <u>The total amount net is just less than $13 million and it's relatively immaterial to our balance sheet overall</u>. As to the homebuilders, we are constantly looking over all of the companies that we lend to

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that are backed by subprime mortgages" was "a marketplace that the Company doesn't participate in." ¶358.

> and again, <u>we feel very strongly that our exposure there is amply covered and we don't expect any losses in that sector</u>.

¶275 (emphasis added). Betsy Cohen also made false statements on this call, telling investors, "Underscore the fact that we don't expect any losses in this sector . . . we watch these carefully, as Daniel said" (*id.*), and "as Daniel has described to you, RAIT has both corporate and real estate-specific lines of lending. Both of these markets are healthy today." ¶274.

These statements blatantly misstated the extent of RAIT's credit exposure and were false when made. ¶276. Indeed, the Section 10(b) Defendants admit in their opposition that NovaStar's principle business was "subprime" (RAIT Mem. at 4), and they do not dispute the Complaint's allegation that RAIT had $25 million in exposure to NovaStar alone. ¶94. Similarly, the Complaint alleges (and Defendants do not dispute) that RAIT had exposure to numerous subprime-related and homebuilder companies, with total exposure reaching into the hundreds of millions of dollars. *See* ¶94. Moreover, Defendants statements were made at a time when (unbeknownst to investors) the specific TruPS issuers underlying the "first loss" pieces of the CDOs retained by RAIT were experiencing extreme financial distress. *See* ¶¶ 235-41, 252, 261-65, 277-79, 283-87, 309. Given these allegations, there can be no dispute—indeed, there is none—that the Complaint adequately alleges that these statements were materially false and misleading.

In sum, the Section 10(b) Defendants have conceded, as they must, that the Complaint adequately alleges that certain of the oral statements they made in conference calls to investors during the Class Period were materially false and misleading.[16]

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[16] It is well-established that a failure to raise an issue in an opening brief constitutes a waiver of that issue. *See, e.g., Anspach v. Phila., Dep't of Pub. Health*, 503 F.3d 256, 259, n.1 (3d Cir. 2007) ("Absent compelling circumstances not present here, failure to raise an argument in one's opening brief waives it"); *Graden v. Conexant Sys., Inc.*, 496 F.3d 291, 296, n.7 (3d Cir. 2007) (same); *Am. Home Mortgage Corp.*

2. **The Complaint Adequately Alleges That The Section 10(b) Defendants Made Material Misstatements Regarding the Company's Financial <u>Performance And Compliance With GAAP</u>**

Throughout the Class Period, the Section 10(b) Defendants repeatedly filed documents with the SEC stating that RAIT's financial statements conformed with SFAS 115—a GAAP provision that required the Company to evaluate whether its credit portfolio (primarily its TruPS and subordinated debt investments) had suffered an "other-than-temporary impairment."[17] *See* ¶¶141-49; 307-15. These statements were false.

There is no dispute that RAIT was required by SFAS 115 to record a write-down in the carrying value of its TruPS investments, with an accompanying charge against earnings, if those

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v. First Am. Title Ins. Co., Civ. No. 07-01257, 2007 WL 3349320, at *3, n.8 (D.N.J. Nov. 9, 2007) (same); *see also Greenwood Partners, L.P. v. Cimnet, Inc.*, No. 2:01-CV-06624, 2003 WL 22238981, at *2 (E.D. Pa. Sept. 26, 2003) (Davis, J.) (holding that "[w]here a party makes no more than a single mention of a claim, the claim is consequently waived," and citing extensive authority for the proposition that an issue is "waived if not raised in [a] party's opening brief.").

[17] The Section 10(b) Defendants made these statements in numerous documents they signed and filed with the SEC, including (1) the June 8, 2006 Form 8-K and Press Release (¶¶334-37) (quoting Defendants Betsy Cohen and Daniel Cohen); (2) the Joint Proxy statement mailed to shareholders on November 7, 2006 (¶¶86-91); (3) the December 11, 2006 Form 8-K/A (¶¶340-45) (signed by Defendant Salmon); (4) the January 2007 Registration Statement (¶¶113-120) (signed by each of the Section 10(b) Defendants and others); (5) the February 21, 2007 Form 8-K and attached Press Release (¶¶244-47, 346-48) (signed by Defendant Salmon); (6) the Form 10-K for the fiscal year ended December 31, 2006 (¶¶46-48, 128-32) (signed by Defendants Betsy Cohen, Daniel Cohen and Salmon); (7) the March 20, 2007 Form 8-K (signed by Defendant Salmon) with attached slide presentation (¶¶256-57); (8) the March 31, 2007 Form 10-Q (¶¶46, 48, 351-52) (signed by Defendants Daniel Cohen and Salmon); (9) the April 13, 2007 Form 8-K (signed by Defendant Salmon) and attached Press Release (¶¶353-54); (10) the May 1, 2007 Form 8-K (signed by Defendant Salmon) and attached April 30, 2007 Press Release (¶¶355-57); (11) the June 5, 2007 Form 8-K (¶¶365-68) (signed by Defendant Salmon); (12) the June 25, 2007 Form 8-K (¶¶369-75) (signed by Defendant Salmon); (13) the July 19, 2007 Form 8-K (signed by Defendant Salmon) and attached Press Release (¶¶376-79); (14) the July 2007 Registration Statement (¶¶124-39) (signed by Defendants Betsy Cohen, Daniel Cohen, Salmon, DiStefano, Brown, Farnesi, Makadon, Promislo, Quigley and Stempel); and (15) the August 2, 2007 Form 8-K (signed by Defendant Salmon) and attached August 1, 2007 Press Release (¶¶380-86). In addition to these false written statements, Defendants also issued the following oral false statements reporting RAIT's financial results: (1) Jack Salmon's statements of RAIT's income made on the February 22, 2007 conference call (¶349); (2) Daniel Cohen's and Jack Salmon's statements of RAIT's income and TruPS valuations on the May 1, 2007 conference call (¶¶360-62); and (3) Daniel Cohen's and Jack Salmon's statements of RAIT's income and TruPS valuations on the August 2, 2007 conference call. ¶¶387-88.

investments were other-than-temporarily impaired as of the close of any given reporting period. ¶¶140-41. The Complaint sets forth the factors relevant to making a SFAS 115 impairment decision and alleges particularized facts that required RAIT to record such an impairment. These factors are (i) market conditions in the real estate industry, including the mortgage and homebuilder industries; (ii) the financial condition of the Company's TruPS issuers; (iii) the length of time the fair value of its assets was below the amortized cost carrying value; and (iv) the lack of evidence indicating that the realizable value of RAIT's TruPS investments would recover enough to equal or exceed their carrying value.[18] ¶¶307-15. The Complaint alleges particularized facts relating to each factor, including:

- **Conditions in the Real Estate Industry.** The Complaint contains numerous detailed factual allegations setting forth negative developments in the real estate industry generally. ¶¶82-84, 110-111, 243, 253-255, 266, 280, 288.

- **Financial Condition of RAIT's TruPS Borrowers**. The Complaint contains many detailed allegations relating to the twelve specific TruPS borrowers uncovered by Lead Plaintiffs' investigation. These allegations demonstrate that RAIT's TruPS borrowers were in severe financial distress prior to and during the Class Period. For instance:

    i) WCI. In the second quarter of 2006, WCI reported a 70% decline in its net income, with its liquidity essentially evaporating from a balance of $52.6 million at December 31, 2005 to $2.0 million at June 30, 2006. As of September 30, 2006, WCI's current obligations exceeded its available liquid assets. ¶309(a).

    ii) Tarragon. In Tarragon's September 30, 2006 10-Q, it reported short-term obligations exceeding current liquid assets by more than $40 million. And in its December 31, 2006 Form 10-K, Tarragon stated that "as of March 31, 2007, we were not in compliance with a debt service coverage ratio covenant." Unsurprisingly, Tarragon defaulted on its debt (including its debt to RAIT). ¶309(c).

[18] It is noteworthy that Grant Thornton "generally agrees with Plaintiffs' description in the Complaint of how [S]FAS 115 is applied and the factors considered in determining whether a particular security is other than temporarily impaired." GT Mem. at 14.

iii) New York Mortgage. New York Mortgage reported a net loss and had liquid assets roughly equal to its short-term obligations for the first two quarters of 2006, and a net loss of $5.5 million for the nine months ended September 30, 2006. In its December 31, 2006 Form 10-K, New York Mortgage reported that it had sold both its wholesale mortgage origination business and its retail mortgage lending origination business due to decreased performance in its portfolio. ¶309(e).

iv) Orleans. In Orleans' September 30, 2006 Form 10-Q, it reported approximately $30.0 million of available liquid assets versus more than $80.0 million of short-term obligations. In its December 31, 2006 Form 10-K, Orleans again reported short-term obligations in excess of liquid assets, while reporting a $7.5 million net loss for that quarter. Orleans also stated in its December 31, 2006 Form 10-K that it had recorded impairments resulted in the company violating its debt service ratio covenant for its revolving loan credit facility. ¶309(f).

v) Impac. Impac reported a $131.3 million loss for the quarter ended September 30, 2006. In its December 31, 2006 Form 10-K, Impac reported a net loss for the year of $90.0 million. For the quarter ended March 31, 2007, Impac suffered a $121.7 million net loss. ¶309(g).

vi) Others. The Complaint contains numerous additional allegations relating to RAIT's other specific TruPS borrowers. *See* ¶¶94-105, 107-09, 234-41, 252, 260-65, 277-79, 282-87, 309.

- **Length of Time of Impairment**. The fair value of RAIT's TruPS investments were less than their carrying value as of December 31, 2005. These assets remained far below their carrying value as of June 30, 2006, September 30, 2006, December 31, 2006, March 31, 2007 and June 30, 2007. Thus, RAIT's TruPS portfolio was less than its carrying value for at least nineteen consecutive months and throughout the Class Period never had a fair value that equaled or exceeded its carrying value. ¶308.

- **Lack of evidence indicating that impairment was merely temporary**. Given the industry-wide crisis in the mortgage and homebuilder markets (and the issues with specific companies identified herein) there existed no evidence indicating that the impairment of RAIT's TruPS investments was merely temporary.

Notably, Defendants do not challenge the Complaint's identification of the twelve TruPS issuers that Lead Plaintiff, through Lead Counsel's investigation, has determined were included in RAIT's TruPS portfolio during the Class Period. *See* ¶94. As alleged in the Complaint, while the identity of these TruPS issuers were not disclosed to investors, the rampant problems within the industry as a whole and with these specific issuers (which were known to Defendants) should have made it clear to the Section 10(b) Defendants that RAIT was unlikely to receive full payment on its TruPS portfolio. ¶¶142, 312. This is particularly true given that the Company's TruPS and other investments collateralized RAIT's "first loss," or lowest-rated, retained pieces of its CDOs, which would become impaired if the TruPS issuer was unable to make <u>any portion</u> of its required payments. [19]

In response to these well-pled allegations, Defendants make a number of fact-intensive arguments attempting to show that the 146-page Complaint fails to adequately allege a single misleading statement or omission relating to RAIT's purported compliance with GAAP. Defendants' arguments involve lengthy discussions of the "judgmental" nature of the factors involved in applying SFAS 115, or otherwise argue that contrary to the allegations of the Complaint, RAIT applied SFAS 115 correctly. RAIT Mem. at 17-20; GT Mem. at 12-17. These arguments should not be considered on a motion to dismiss.

Indeed, Defendants repeatedly ignore or distort the Complaint's allegations. For instance, the Section 10(b) Defendants state that the "negative events in the real estate market [alleged in the Complaint] . . . have absolutely nothing [sic] do with the 12 TruPS borrowers identified in the Complaint." RAIT Mem. at 19. This argument is flatly wrong and ignores that (i) SFAS 115 expressly states that market and industry-wide factors must be considered in

[19] The Complaint also sets forth with particularity the impact that RAIT's failure to comply with GAAP had on the Company's publicly-reported financial statements. *See* ¶¶147-49. For the fiscal year ended March 31, 2007, RAIT overstated its net income available to common shares by 1,211%, its net income by 1,080%, and its earnings per share by 1,109%. ¶313. For the quarter ended September 30, 2006, RAIT reported net income of $69 million when its actual net income (had it taken the required write-down), was <u>negative $177.7 million</u>—an overstatement of more than 200%. ¶147. Similarly, while RAIT reported earnings per share of $1.20 for the same quarter, it actually <u>lost</u> $3.61 per share. In short, had RAIT taken the impairment charges required by GAAP, it would have wiped out the Company's reported net income for the entire Class Period. ¶145.

making any impairment determination (¶143); and (ii) the Complaint contains numerous detailed, contemporaneous factual allegations relating to serious financial problems faced not only by the industry as a whole, but also by the very TruPS borrowers identified in the Complaint. *See* ¶¶94-103, 107-09, 234-41, 252, 260-65, 277-79, 282-87, 309.

The Section 10(b) Defendants also argue that SFAS 115 requires an assessment of RAIT's "intent and ability . . . to retain its investment . . . for a period of time sufficient to allow for any anticipated recovery in market value." RAIT Mem. at 21. But the mere recitation of a single factor in SFAS 115 does not provide any basis for trumping the Complaint's detailed allegations regarding RAIT's failure to apply the other factors. This is particularly true because the Section 10(b) Defendants do not say how this one factor purportedly supports RAIT's decision not to take a write-down and they do not even attempt to argue that RAIT actually complied with this factor (which is not surprising since RAIT did not, in fact, hold its TruPS securities long enough for them to recover in value—they were written down after the Class Period. *See* ¶¶304-06.[20]

These types of factually-specific and subjective arguments regarding the "proper" application of GAAP are routinely rejected by Court's on a motion to dismiss. They should be

[20] The Section 10(b) Defendants also incorporate Grant Thornton's arguments regarding GAAP. RAIT Mem. at 21, n.14. (As discussed below, Grant Thornton is not sued for fraud. Rather, liability is asserted against it pursuant to Section 11 of the Securities Act for its audit letter certifying that RAIT's 2007 Form 10-K complied with GAAP, which Grant Thornton consented to have incorporated into the offering documents for the July 2007 Preferred Stock Offering. Grant Thornton contends it was a "peripheral player in this "potentially massive securities fraud action." GT Mem. at 2) Grant Thornton devotes several pages to arguing that the alleged GAAP violations were "based on estimates and predictions" performed by RAIT's management. GT Mem. at 13-15. Grant Thornton also distorts the allegations of the Complaint by contending that "Plaintiffs ignore the individual assets and, instead, rely exclusively on contemporaneous news articles and press releases regarding general market conditions." GT Mem. at 21. This is incorrect. As discussed herein, the Complaint contains numerous allegations about the specific TruPS that were included in RAIT's portfolio—the precise "assets" that Grant Thornton wrongly asserts the Complaint ignores. *See* ¶¶94-105, 107-09, 234-41, 252, 260-65, 277-79, 282-87, 309.

rejected here as well. In *Florida State Bd. of Admin. v. Green Tree Fin. Corp.* (discussed in more detail below), the Eighth Circuit reversed the dismissal of claims asserted against a real estate company similar to RAIT, stating that "undoubtedly the accounting issues are complex . . . . We will not prejudge that issue . . . neither the district court, nor we, can conduct a battle of experts on a motion to dismiss. Rather, we must assume the truth of the allegations pleaded with particularity in the complaint." 270 F.3d 645, 666 (8th Cir. 2001) (emphasis added);[21] s*ee also In re Burlington Coat Factory Sec. Lit.*, 114 F.3d 1410, 1421 (3d Cir. 1997) (holding that whether a defendant's accounting practice was consistent with GAAP is a factual question not to be decided on a motion to dismiss); *In re Refco, Inc. Sec. Litig.*, 503 F. Supp. 2d 611, 656-57 (S.D.N.Y. 2007) ("At the motion to dismiss stage, the plaintiffs' assertion that certain practices were not generally accepted must be taken as true") (internal citations omitted); *In re Majesco Sec. Litig.*, No. 05CV3557(PGS), 2006 U.S. Dist. LEXIS 73563, at *14, *22-23 (D.N.J. Sept. 26, 2006) ("[Auditor] defendant's contention that the Complaint fails to provide adequate factual support for the accounting misstatements is unpersuasive. Whether any or all of the aforementioned statements were, in fact, misstatements in violation of GAAP or GAAS is an issue to be determined at a later date and not on a motion to dismiss."). *See also In re Ibis Tech. Sec. Lit.*, 422 F. Supp. 2d 294, 315 (D.Mass. 2006) (holding that plaintiffs adequately pled GAAP violations for failure to write-down assets because they alleged facts showing that the

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[21] *Green Tree* illustrates a critical point that is particularly relevant here—disputes over the proper application of GAAP involve not only complex factual determinations, but also expert accounting evidence. Indeed, in this case, Lead Counsel consulted with an accounting expert in connection with drafting the Complaint, and that expert, based on the information contained in the Complaint, concurs with the allegations that Defendants plainly violated GAAP throughout the Class Period. While Defendants will presumably seek to hire an expert during discovery who will say the opposite, these types of expert disputes (based on underlying factual disputes) cannot be resolved on the pleadings. *Green Tree Fin.* Corp., 270 F.3d at 666 (refusing to "conduct a battle of experts on a motion to dismiss").

"semiconductor industry in general and Ibis in particular were moving away from" the asset that allegedly was overvalued); *In re Aetna Inc. Sec. Litig.*, 34 F. Supp. 2d 935, 956 (E.D. Pa. 1999) (holding that plaintiffs adequately pled GAAP violations because they "stated what the alleged unreasonable accounting practices were and how Defendants allegedly distorted their earnings").[22]

In a similar vein, the Section 10(b) Defendants argue that the Complaint's allegations regarding the financial troubles of RAIT's TruPS borrowers "focus [] almost entirely on equity events [and] . . . debt holders—like RAIT—quite reasonably might not share those concerns." RAIT Mem. at 20. To begin with, whether RAIT "quite reasonably" might or "might not share those concerns" is yet another fact question that cannot be decided on a motion to dismiss (particularly not in Defendants' favor). Moreover, the Complaint sets forth in detail significant "liquidity concerns" faced by RAIT's TruPS borrowers.[23] Because these alleged shortfalls in liquidity (among other things) certainly should have raised concerns about the ability of these companies to satisfy their obligations, the Section 10(b) Defendants' argument lacks merit.

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[22] Another example of the Section 10(b) Defendants ignoring or distorting the allegations of the Complaint is their argument that because RAIT recorded temporary "gross unrealized losses" on its "available for sale securities," their fraudulent failure to take the permanent impairment charges required by SFAS 115 is somehow excused. RAIT Mem. at 16-17, 25. As the Complaint alleges, these temporary charges were part of the fraud. By taking "unrealized losses," RAIT <u>avoided taking impairments required by SFAS 115 and avoided the concomitant write-downs of net income, earnings per share and other financial results.</u> ¶307 ("by only taking temporary charges, RAIT avoided taking necessary charges to earnings, and therefore gave a materially false and misleading picture of its true results of operations for a given period."). This point is discussed in more detail in Section I.A.3, below.

[23] *See, e.g.*, ¶¶309(a) (WCI's liquidity had evaporated by June 30, 2006); ¶309(b) (HomeBanc was selling "all of our securities as a means of generating liquidity" in early 2007); ¶309(c) (Tarragon's short-term obligations exceeded its current liquid assets by more than $40 million as of September 30, 2006); ¶309(d) (Levitt's short-term obligations exceeded its liquid assets by more than $100 million as of December 31, 2006); ¶309(f) (Orleans had $30 million in liquid assets verses more than $80 million in short-term obligations as of September 30, 2006); ¶309(h) (AHM's net income plunged by 50% during the first quarter of 2006 and for every quarter from September 30, 2006 through the end of the Class Period, AHM reported short term obligations in excess of its liquid assets).

The Section 10(b) Defendants also make an artful assertion that the Complaint does not "allege" that any TruPS borrowers other than AHM defaulted on a payment during the Class Period (notably, they do not state that there were no such defaults, or waivers of defaults, at any point during the Class Period). According to Defendants, because the Complaint does not allege that other TruPS issuers actually defaulted during the Class Period, SFAS 115 did not require a write-down of RAIT's assets. RAIT Mem. at 20. This argument—that GAAP does not require a write-down until after a company defaults—turns SFAS 115 on its head. During the Class Period, RAIT told investors that it complied with SFAS 115, which places the burden squarely on RAIT to value its TruPS portfolio and determine whether it was "probable that [RAIT] will be unable to collect all amounts due according to the contractual terms of a debt security." ¶142 (emphasis added). If a company were not required to make this assessment until after a default had already occurred, SFAS 115 would be meaningless. As discussed, the Complaint alleges numerous facts that made it at least "probable" that RAIT's TruPS portfolio had suffered an other-than-temporary impairment prior to or during the Class Period. (Indeed, these defaults were quite certainly "inevitable," and ultimately occurred).[24] *See, e.g.*, ¶¶140-49, 307-15; *see also* ¶¶82-111, 234-43, 252-55, 260-66, 277-86, 309.

Certain Defendants next argue that the Complaint's allegations of GAAP violations and financial misstatements are an improper attempt to plead "fraud by hindsight." RAIT Mem. at

[24] In any event, the Section 10(b) Defendants' reaction to AHM's default demonstrates how blatantly they disregarded GAAP during the Class Period. While the Section 10(b) Defendants concede that AHM defaulted on $95 million in debt during the Class Period (RAIT Mem. at 20), RAIT did not evaluate its credit portfolio for a permanent impairment until two months later, as of September 30, 2007—when RAIT finally conceded that it was required to take $247 million in impairment charges and had up to $622 million in permanent impairments and remaining exposure. ¶306. This failure was particularly egregious because Defendants already knew of AHM's default at the time they released their Form 10-Q for the second quarter of 2007, but they still did not apply SFAS 115 to take an impairment charge as of that time. *See* ¶¶380-86 (RAIT released its second quarter 2007 results at the same time it announced AHM's default).

19; UW Mem. at 7-19. Defendants are wrong. During the Class Period, Defendants refused to disclose to investors the identity of RAIT's TruPS borrowers, while (falsely) assuring investors that they "continually monitor[ed]" the Company's credit exposure through "ongoing surveillance" that gave them access to "inside information." *See* ¶¶131-32, 250, 275, 297. But as set forth in the Complaint, at least twelve separate TruPS issuers identified by Lead Plaintiff faced significant financial and liquidity problems during the Class Period (*see* ¶¶82-84, 94-110, 234-41, 243, 252-55, 260-66, 277-88, 309), and these contemporaneous facts required RAIT to take a write-down pursuant to SFAS 115 (as did the contemporaneous facts alleged about declining market conditions industry-wide. ¶¶140-59, 307-15. These are not allegations of "fraud-by-hindsight"—they are allegations of fraud based on hard facts that Defendants knew or recklessly disregarded during the Class Period.[25]

In a recent decision, the First Circuit expressly limited the application of the "fraud-by-hindsight" doctrine on a motion to dismiss in light of the Supreme Court's decision in *Tellabs v. Makor Issues & Rights, Ltd.* 127 S. Ct. 2499 (2007). In *Mississippi Pub. Employees' Ret. Sys. v. Boston Scientific Corp.*, the First Circuit stated that under *Tellabs*, "inferences <u>may be drawn favorable to plaintiff by proper recognition of the limits of the doctrine of fraud by hindsight</u>." -- 523 F.3d 75, 90 (1st Cir. 2008) (emphasis added). The First Circuit further stated:

> We recognized that the effect of use of the doctrine [of fraud by hindsight] at the Rule 12(b)(6) dismissal stage is to cut off the case as a matter of law, without further factual development. As some commentators have stated, <u>"At this stage, a court must be cautious. The case has not yet developed. In cutting off the case on</u>

[25] Moreover, there is not, nor could there be, any assertion that the undisputed false statements made by Daniel Cohen and Betsy Cohen including, among others, RAIT's purported commitment to "pristine credit" and "$13 million" and "de minimis" exposure to subprime lenders are allegations of "fraud-by-hindsight." These Defendants indisputably had facts in their possession at the time (including undisputed knowledge of RAIT's $25 million exposure to NovaStar and $294 million in exposure to other subprime-related and homebuilder companies (¶94) that were contrary to the false and misleading statements they made to investors).

> <u>the pleadings by citing hindsight, the court is essentially making a prediction that the discovery process will yield only evidence that requires the benefit of the hindsight bias to seem adequate to support the allegations.</u>"

Id. (quoting M. Gulati, J. Rachlinski & D. Langevoort, *Fraud by Hindsight*, 98 NW. L. REV. 773, 787 (2004) (emphasis added)). The First Circuit went on to reverse the district court's dismissal of a securities fraud complaint because it was a fair inference from the allegations of the complaint that Defendants "knew earlier what they chose not to disclose until later." *Id.* For similar reasons, Defendants' argument that the Complaint attempts to plead "fraud-by-hindsight" here should be rejected at this stage of the litigation.

The Underwriter Defendants' quotation from *Novak v. Kasaks*, 216 F.3d 300, 309 (2d Cir. 2000), demonstrates the weakness of Defendants' "fraud-by-hindsight" argument. As the Underwriter Defendants point out, *Novak* states that "corporate officials need not be clairvoyant; they are only responsible for <u>revealing those material facts reasonably available</u> to them." UW Mem. at 10 (emphasis added). Because the identities of RAIT's TruPS borrowers were plainly known to the Section 10(b) Defendants, and because the severe financial difficulties they faced were in large part <u>public information</u> (and, of course, because Defendants had a duty to monitor their credit exposure that went beyond simply monitoring public information), the information contradicting their statements to investors was certainly "reasonably available" to them. Indeed, it was right under their noses. Thus, *Novak* primarily demonstrates why Defendants' "fraud-by-hindsight" argument is unfounded.[26] *See also Monroe Employees Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651, 677 (6th Cir. 2005) (rejecting "fraud by hindsight" argument and sustaining securities fraud complaint based on company's "representation to the investing public that no

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[26] In fact, *Novak* demonstrates that the Complaint in this case should be sustained. In *Novak*, the Second Circuit rejected the same arguments raised by Defendants here and sustained securities fraud claims under the PSLRA based on allegations that defendants—just like the Defendants here—failed to properly write-down inventory that they should have known was impaired. *See* 216 F.3d at 308-09, 312-13.

impairment of Bridgestone's corporate assets was substantially certain to occur [because of defects in the company's tires]"); *In re PMA Capital Corp. Sec. Litig.*, No. 03-6121, 2005 WL 1806503, at *10 (E.D. Pa. July 27, 2005).[27]

Finally, certain Defendants argue that the Complaint does not adequately allege a misstatement relating to RAIT's compliance with GAAP or its publicly reported financial results because RAIT has not restated its financial statements (at least not yet). *See* RAIT Mem. at 11; UW Mem. at 12. Courts have repeatedly recognized that a company's decision not to restate its financial statements has no bearing whatsoever on whether a complaint adequately pleads whether those financial statements were false when issued. As the First Circuit held in *Aldridge v. A.T. Cross Corp.*:

> The company argues that because it has never restated any of its financials or otherwise indicated any error in the 1998 financial statements, and because its financial statements were audited by an independent accounting firm, no inference of accounting error . . . can be drawn. We disagree. Had the 1998 financials been restated, that might well have been useful to Aldridge. However, the fact that the financial statements for the year in question were not restated does not end Aldridge's case when he has otherwise met the pleading requirements of the PSLRA. <u>To hold otherwise would shift to accountants the</u>

[27] The Underwriter Defendants' other cases are equally off-point. In *In re Acceptance Ins. Cos. Sec. Lit.* (UW Mem. at 9), the dismissed claim was based entirely on comments that defendants made after they issued the registration statement, which is why the court described plaintiffs' approach as "retrospective." *See* 423 F.3d 899, 903 (8th Cir. 2005) ("The Appellants' are only able to cite comments <u>after</u> the [registration] statement was issued." (emphasis added)). Indeed, those plaintiffs failed to allege <u>even a single contrary fac</u>t known to (or available to) defendants before the issuance of the allegedly false registration statement. *Id.* Likewise, the Underwriter Defendants' citation to *Denny v. Barber* is not helpful to them. UW Mem. 10-11. The complaint in *Denny* was so barren that it failed to identify the alleged misstatements and asserted only that certain loans were "speculative and risky," with "no specification of what loans, at what times, and in what amounts were 'risky.'" *Id.* at 469; *see also id.* (noting that "the misstatements . . . are nowhere described," "the amended complaint does not state what items in the 1973 Annual Report were knowingly false," and amounted to "the simple use of the epithet 'risky'"). In contrast, this Complaint quite clearly and specifically identifies many false statements within the registration statements (¶¶115-20, 125-39), identifies several impaired TruPS investments (¶94), and explains why they should have been written down before or during the Class Period (¶¶82-84, 94-111, 140-49).

> responsibility that belongs to the courts. It would also allow officers and directors of corporations to exercise an unwarranted degree of control over whether they are sued, because they must agree to a restatement of the financial statements.

284 F.3d 72, 83 (1st Cir. 2002) (emphasis added); *see also In re Williams Sec. Litig.*, 339 F. Supp. 2d 1206, 1222 n.4 (N.D. Okla. 2003) ("Many of the factors which admittedly caused the write-downs were operative throughout the Class Period, but their impact was not properly reflected. Further, the fact that [the Company's] financial results were not restated does not mean that the financial results disseminated during the Class Period were accurate." (citing *Aldridge*)); *Feiner v. SS & C Techs., Inc.*, 11 F. Supp. 2d 204, 209 (D. Conn. 1998) ("[T]he fact that [the company] has not elected to restate or reverse its earnings or revenue figures . . . does not indicate, much less prove, the accuracy of those figures."). Accordingly, RAIT's decision (so far) not to issue a formal restatement of its Class Period financial statements (a decision entirely within the control of the Section 10(b) Defendants and other Defendants) does not overcome the Complaint's well-pled allegations of falsity.

In sum, the Complaint adequately alleges that the Section 10(b) Defendants made misstatements regarding RAIT's compliance with GAAP, and overstated RAIT's reported financial results during the Class Period.

3. The Section 10(b) Defendants' Misleading Statements Regarding The Company's Credit Monitoring Were Material To Investors

Throughout the Class Period, the Section 10(b) Defendants stated in RAIT's public filings that RAIT conducted "ongoing surveillance" and obtained "inside information" regarding the financial performance of its TruPS issuers. *See, e.g.*, ¶¶132, 297. They told investors that the Company "actively monitor[ed] our investments" by several means, including direct calls and visits with its borrowers, and a review of "public filings," "reports," and "other sources of data" available to RAIT. *See, e.g.*, ¶¶105, 131-32.

As RAIT stated in its Form 10-K for the fiscal year 2006, which was signed by Defendants Daniel Cohen, Betsy Cohen and Jack Salmon, "the cornerstone of our investment process is credit analysis and risk management." ¶132; *see also* ¶116 (the January 2007 Registration Statement stated that "[c]ore components of our business include . . . a disciplined credit underwriting process"). RAIT also stated in its 2006 Form 10-K that:

> [W]e manage our credit risk, primarily the risk our borrowers will not repay us, by an <u>integrated and disciplined process which analyzes the sustainability and adequacy of a potential borrower's cash flow, liquidity and capital and the quality and experience of management.</u>

¶132 (emphasis added).

Recognizing that investors were particularly focused on whether RAIT's TruPS and other investments were negatively impacted by the declining real estate markets, RAIT stated in its 2006 Form 10-K that "our credit analysts continually monitor our assets for potential credit impairment . . . and will do so even more closely for borrowers who are on one of our watch lists." *Id.* These statements were materially false and misleading.[28]

When viewed in the "total mix of information" with Daniel Cohen's and Betsy Cohen's statements on conference calls that RAIT was "dedicated to pristine credit" (¶349), took a "conservative stance" toward credit exposure (¶¶249, 272), had "no risks in terms of [its] underlying finance structure" (¶68), focused on "low-risks asset classes" (¶71), was "constantly

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[28] The Complaint also contains allegations regarding RAIT's credit underwriting process (as distinct from its credit monitoring process). *See, e.g.*, ¶¶68-71, 86, 116-17, 125, 131-32, 256. The Section 10(b) Defendants argue at length that they did not make any actionable false statements relating to RAIT's credit underwriting. *See* RAIT Mem. at 10-15. Because RAIT often described its underwriting process and its monitoring process together, the Section 10(b) Defendants made similar statements about both. While the Complaint certainly contains sufficient allegations to infer that RAIT's statements about its underwriting process were false when made, RAIT's statements about its credit monitoring process are particularly relevant because RAIT assumed Taberna's CDOs upon the merger (and these CDOs had <u>already</u> been underwritten)—which required RAIT to constantly monitor these investments to ensure there was no permanent impairment. *See* ¶¶80-84, 94.

looking over all of the companies that we lend to," (¶275), and other similar statements (*see, e.g.*, ¶¶116, 131-32, 249-51, 349-51), RAIT's statements regarding its credit monitoring process were intended to deceive investors that RAIT regularly evaluated its TruPS issuers and was well positioned to identify a potential default and to make the impairment determination required by SFAS 115. *See Weiner v. Quaker Oats Co.*, 129 F.3d 310, 317 (3d Cir. 1997) (reasoning that court cannot view any one statement in isolation, and concluding that "taken together, the statements could indeed have" been material). As became clear at the end of the Class Period, however, RAIT did not engage in any meaningful credit monitoring activities whatsoever. Indeed, RAIT's supposed "ongoing surveillance" of its TruPS issuers was so deficient that the Company did not identify an impairment to any asset until <u>after AHM had already defaulted</u> on its payment obligations relating to $95 million worth of (previously undisclosed) debt owed to RAIT. ¶¶291-303. RAIT failed to timely identify the risk of AHM's default despite numerous public pronouncements that AHM was experiencing non-accruing loans (¶252), was writing down $484 million of securities (¶262), and was operating under the "working assumption [] that current market conditions will persist and that our gain on sale margins will not recover through the balance of the year." ¶261. Had RAIT been monitoring the credit of its borrowers in the diligent manner represented to investors, these issues (and others) would have alerted the Company to the impending and inevitable defaults long before they happened.

Moreover, RAIT's other TruPS issuers were experiencing similarly severe problems prior to and during the Class Period, but these problems were also ignored by RAIT's supposedly diligent credit analysts until after the Class Period. For instance, TruPS issued by homebuilder Tarragon were placed on "ratings watch negative" by Fitch Ratings on October 4, 2006—a rating that meant the TruPS were in danger of being downgraded to "junk" status. ¶103. And as of

September 30, 2006, Tarragon reported that its short-term obligations exceeded its current liquid assets by more than $40 million. ¶309(c). Orleans reported that as of September 30, 2006, it had $30 million of available liquid assets versus more than $80 million of short-term obligations. ¶309(f). And as of December 31, 2006, Orleans was in default of the loan covenants on its short-term credit facility. *Id.* Prior to and during the Class Period, similar red flags were apparent throughout RAIT's TruPS portfolio. *See, e.g.*, ¶¶94-103, 107-09, 234-41, 252, 260-65, 277-79, 282-87, 309.

Nonetheless, and despite RAIT's assurances that it "even more closely" monitored issuers that were on its "credit watch list" (¶132), RAIT did not take a single impairment charge until September 30, 2007—long after it was required by GAAP and long after multiple defaults already had occurred. At that time, RAIT shocked the market by taking over $247 million of permanent impairment charges to its TruPS portfolio—a staggering write-down given that a few short months earlier the Section 10(b) Defendants had told investors that RAIT had only $13 million of total exposure. ¶¶272-75. If RAIT's credit monitoring processes had been as active and diligent as RAIT represented, these impairments would have been identified far earlier than they were. Indeed, as alleged in the Complaint, if RAIT had simply monitored the public filings of its own TruPS issuers, it would have known that its TruPS portfolio was impaired long before September 2007. *See* ¶¶94-103, 107-09, 234-41, 252, 260-65, 277-79, 282-87, 309. In these circumstances, there can be no plausible inference other than these statements were false.

It is well-established that a misrepresentation by a company that it actively monitors its credit portfolios states a claim under the securities laws. For instance, in *Ong IRA v. Sears, Roebuck & Co.*, 388 F. Supp. 2d 871, 893 (N.D. Ill. 2004), the court held that the complaint alleged actionable misstatements by defendants who told investors, among other things, that the company (i) was "conservatively reserved;" (ii) "was monitoring the credit card portfolio on a daily basis to identify any problem accounts and manage outstanding credit risks;" (iii) "the quality of our receivables portfolio has remained strong and our outlook is stable;" and (iv) faced "minimal credit risk." *Id.* (reasoning that defendants "do not cite any evidence suggesting that [they] fairly revealed the risky nature of [the company's] credit practices"); *see also Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 276, n.6 (3d Cir. 1992) (reversing dismissal of claims based, *inter alia*, on statements of "conservative underwriting standards," "a lending philosophy which emphasizes the prompt identification and follow-up of problem loans and a conservative approach to problem loan recognition," and assurances that defendant "carefully monitors [its] portfolio" (alterations incorporated and internal quotation marks omitted)); *In re Dynex Capital, Inc. Sec. Litig.*, No. 05 Civ. 1897, 2006 WL 314524, at *3 (S.D.N.Y. Feb. 10, 2006) (sustaining claims based upon false statements as to company's underwriting criteria); *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier, Inc.*, No. 05 Civ. 1898, 2005 WL 2148919, at *2 (S.D.N.Y. Sept. 6, 2005) (sustaining claims based on false statements as to company's purported "strict and prudent underwriting standards (internal quotation marks omitted)); *Urbach v. Sayles*, Civ. No. 91-1291, 1991 WL 236183, at *1 (D.N.J. Sept. 4, 1991) (sustaining claims based upon false statements as to defendants' purported "careful underwriting of loans" and "continuous and scrupulous monitoring of outstanding loans").

Recognizing that the Complaint adequately alleges that Defendants made false statements regarding the Company's credit monitoring, the Section 10(b) Defendants contend that these statements "cannot be found material." RAIT Mem. at 15. They are wrong. RAIT told investors that "the cornerstone" and "core" of its investment process was "credit analysis and risk management" (¶116, 132), and repeatedly emphasized the Company's supposed "ongoing surveillance" and "active[] monitor[ing]" of its TruPS borrowers throughout the Class Period (¶¶131-32, 250, 256, 275). Importantly, many of these statements were made <u>in response to specific analyst questions about the Company's exposure</u>. ¶¶250, 275. Having used these statements to assuage investor concerns during the Class Period (and inflate the prices of RAIT's publicly traded securities), the Section 10(b) Defendants cannot now argue that these statements were not material as a matter of law. *See Weiner v. Quaker Oats Co.*, 129 F.3d 310, 317 (3d Cir. 1997) ("the emphasis on a fact specific determination of materiality militates against a dismissal on the pleadings.")[29]

Rather, "the Supreme Court has endorsed a fact-intensive test of materiality in securities fraud cases" and "a complaint may not properly be dismissed . . . on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investors that reasonable minds could not differ on the question of their unimportance." *Helwig v. Vencor*, 251 F.3d, 540, 561 (6th Cir. 2001) (emphasis added); *see also In re Adams Golf, Inc. Sec. Litig.*, 381 F.3d 267, 274 (3d Cir. 2004) ("Materiality is ordinarily an issue left to the factfinder and is therefore not typically a matter for Rule 12(b)(6) dismissal."); *In*

[29] For this reason and others, Defendants' citation to *In re Am. Bus. Fin. Serv., Inc. Litig.* is unavailing. *See* RAIT Mem. at 14. The defendants in *In re Am. Bus. Fin. Serv., Inc. Litig.*, unlike the Section 10(b) Defendants here, never told investors that their underwriting and monitoring practices were "core" and "cornerstone" aspects of the company's business. That fact alone renders *In re Am. Bus. Fin. Serv., Inc. Litig.* inapposite. Moreover, the defendants in *In re Am. Bus. Fin. Serv., Inc. Litig.*, unlike the Section 10(b) Defendants here, never reassured the investing public, in response to specific analyst questions regarding credit quality, that they were carefully monitoring the company's portfolio. Finally, the statements held immaterial in *In re Am. Bus. Fin. Serv., Inc. Litig.*—namely, a bare claim that the company had a "strong credit culture"—were exceedingly sparse and vague. *See* No. 05-232, 2007 WL 81937, at *8 (E.D. Pa. Jan. 9, 2007) ("Therefore, I will dismiss the claims based on ABFS's 'strong credit culture.'"); *see also In re Am. Bus. Fin. Serv., Inc. Litig.*, 413 F. Supp. 2d 378, 400 (E.D. Pa. 2005) (finding immaterial statement that defendant was "proud" of company's "continued focus on credit quality [and] application of uniform underwriting standards."). In contrast to the vague description of the company's "culture" at issue in that case, the underwriting and monitoring statements at issue here are extensive, detailed, and specific—as befits a discussion about the "cornerstone" of RAIT's business. For instance, RAIT's Form 10-K for the fiscal year 2006 contained a lengthy description of RAIT's six-step underwriting and monitoring process. ¶131.

re Westinghouse Sec. Litig., 90 F.3d at 714 (Alito, J.) (same); *Shapiro*, 964 F.2d at 280, n.11 ("Materiality is a mixed question of law and fact, and the delicate assessments of the inference a reasonable shareholder would draw from a given set of facts are peculiarly for the trail of fact.").

Defendants also distort the allegations of the Complaint by stating that "a reasonable investor would [not] have believed the Company's monitoring was a guarantee it could avoid losses." RAIT Mem. at 15. This argument misses the point. The Complaint is not alleging that Defendants' supposedly diligent credit monitoring was a guarantee that RAIT could prevent losses. Rather, it alleges that Defendants told investors that, as a "cornerstone" of the business, they were closely monitoring RAIT's TruPS issuers when, in fact, they were not. That is a classic allegation of securities fraud and it should not be dismissed on a motion on the pleadings. *See In re Dynex Capital, Inc. Sec. Litig.*, No. 05 Civ. 1897, 2006 WL 314524, at *12 (S.D.N.Y. Feb. 10, 2006) (rejecting argument that complaint did not identify actionable misrepresentations when "[defendant,] through its public statements, endeavored to ensure the investing public that it utilized adequate underwriting guidelines.")[30]

Finally, the Section 10(b) Defendants argue that the Company's false statements of underwriting or monitoring are immaterial because RAIT recorded temporary "losses" on its TruPS and subordinated debenture portfolio. RAIT Mem. at 16-17, 25. This argument should

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[30] For the same reason, the Section 10(b) Defendants' argument that "plaintiffs were also were [sic] warned that—as a legal matter—the Company very well might not be permitted to avoid losses" is unavailing. RAIT Mem. at 16 (emphasis removed). The Section 10(b) Defendants seem to argue that because it was possible that RAIT might not be able to sell its CDOs pursuant to certain (unspecified) sale restrictions, investors somehow knew that RAIT was lying about its overall exposure and the true condition of its credit portfolio. *See id.* But the Section 10(b) Defendants do not argue—nor could they—that RAIT's losses occurred because of these unspecified "sale restrictions." Thus, this argument is pure speculation and has no bearing whatsoever on the facts alleged in the Complaint. Moreover, to the extent that investors were concerned that RAIT might face exposure to declining market conditions, the Section 10(b) Defendants (falsely) assured them that this exposure was "de minimis" and less than $13 million (as well as by failing to record such a permanent impairment in RAIT's financial statements). ¶¶250, 275.

be rejected for two reasons. First, as the Complaint alleges, these temporary charges were part of the fraud. By taking "unrealized losses," RAIT avoided taking impairments required by SFAS 115 and avoided the concomitant write-downs of net income, earnings per share and other financial results. ¶307 ("By only taking temporary charges, RAIT avoided taking necessary charges to earnings, and therefore gave a materially false and misleading picture of its true results of operations for a given period."). Second, RAIT quite clearly told investors that these temporary, unrealized "losses" reflected "interest rate factors rather than credit impairment." *See* ¶¶134, 298 (emphasis added). Indeed, RAIT told investors as much on three separate occasions: (i) in its Form 10-Q for the 2007 first quarter (¶134); (ii) in its July 2007 Registration Statement, which incorporated that Form 10-Q (¶¶133-34); and (iii) after the Class Period, when Jack Salmon admitted that the so-called unrealized "losses" principally reflected "interest rate degradation" rather than credit impairment (¶298). Accordingly, as the Section 10(b) Defendants have admitted, these temporary value adjustments did not concern the purported creditworthiness of RAIT's borrowers, and therefore cannot render immaterial any false statement related to that subject.

B. The Complaint Adequately Alleges That Each Section 10(b) Defendant Acted With Scienter

The Section 10(b) Defendants also argue that the Complaint must be dismissed because it fails to allege the element of scienter with the particularity required by the PSLRA. RAIT Mem. at 30-37. This argument should be rejected.

The Court, in determining whether the Complaint alleges facts giving rise to a strong inference of scienter, must determine "whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard." *Tellabs,* 127 S. Ct. at 2509; *see also In re WorldCom, Inc. Sec.*

Litig., 294 F. Supp. 2d 392, 417 (S.D.N.Y. 2003) ("The allegations in the Complaint are entitled to be taken together to determine if the facts 'give rise to a strong inference of fraudulent intent.'" (internal citation omitted)) If the totality of the circumstances alleged raises a 'strong inference' of the requisite state of mind, "it is immaterial whether plaintiffs satisfy their burden by 'pleading motive and opportunity, conscious misbehavior, recklessness, or by impressing upon the Court a novel legal theory.'" *In re MicroStrategy, Inc. Sec. Litig.*, 115 F. Supp. 2d 620, 631 (E.D. Va. 2000) (quoting *In re Health Mgmt., Inc. Sec. Litig.*, 970 F. Supp. 192, 201 (E.D.N.Y. 1997)).[31]

In ruling on a motion to dismiss, a court must consider the factual allegations of the complaint in their entirety, and take into account only those "plausible opposing inferences"—*i.e.*, plausible nonculpable explanations for the defendant's conduct—that may be "rationally drawn from the facts alleged," *id.* at 2504 (emphasis added).[32] As long as the inference of scienter is *at least as compelling* as any plausible opposing inference that can be drawn, the complaint must be sustained. *Id.* at 2509. Accordingly, on a motion to dismiss, it is the defendant's burden to demonstrate that the allegations give rise to an inference of nonculpable conduct that is *stronger* than the inference of scienter. *Id.* at 2504-05.

[31] Although claims asserting violations of Rule 10(b)(5) must comply with the particularity requirement of Fed. R. Civ. P. 9(b), "courts should not demand a level of specificity in fraud pleadings that can only be achieved through discovery." *Liberty Ridge LLC v. Realtech Sys. Corp.*, 173 F. Supp. 2d 129, 137 (S.D.N.Y. 2001). "Even with the heightened pleading standard under Rule 9(b) and the [PSLRA] we do not require the pleading of detailed evidentiary matter in securities litigation." *In re Scholastic Corp., Sec. Litig.*, 252 F.3d 63, 72 (2d Cir. 2001).

[32] While this is a slightly different standard than previously set forth by the Second Circuit, which directed trial courts to draw all reasonable inferences in favor of the plaintiff, it is a change that does not affect the outcome in this (or most) cases unless the defendants come forward and demonstrate more compelling opposing inferences that should be drawn from the facts alleged. Defendants certainly cannot do so here.

In the Third Circuit, a plaintiff may allege scienter in two ways. First, a plaintiff may plead facts that "constitute strong circumstantial evidence of conscious misbehavior or recklessness." *In re Suprema Specialties, Inc. Sec. Litig.*, 438 F.3d at 276. Second, a plaintiff may plead facts showing that a defendant had "the motive and opportunity to commit the fraud." *Id.* As set forth more fully below, under each of those independent theories, the facts alleged in this Complaint give rise to an inference of scienter that is at least "as likely as" any innocent explanation, and therefore "strong" within the meaning of the PSLRA. *See EP Medsystems, Inc. v. EchoCath, Inc.*, 235 F.3d 865, 880 (3d Cir. 2000) (plaintiffs may "plead scienter by alleging facts establishing a motive an opportunity to commit fraud, or by setting forth facts that constitute circumstantial evidence of either reckless or conscious behavior.")

1. The Detailed Allegations Of The Complaint, Considered Together, Give Rise To An Inference Of At Least Recklessness

The Complaint's allegations, when considered holistically as required by *Tellabs*, give rise to a strong inference of at least recklessness by the Section 10(b) Defendants that is far more compelling than any other "innocent explanation" for their false statements. Among other things, the Section 10(b) Defendants' knowledge or extreme recklessness is established by the facts that (1) they were the most senior executives of RAIT and repeatedly made misstatements that concerned RAIT's core business and operations; (2) these Defendants had access to a wide array of information about RAIT's credit exposure, its TruPS borrowers and the market as a whole that directly contradicted their false statements to investors; (3) the Section 10(b) Defendants had a duty to monitor information regarding RAIT's credit exposure, which they ignored; and (4) the size of the impairment that RAIT eventually took to its TruPS portfolio—$315 million in impaired debt (and $620 million in total exposure), and the disparity between that impairment and exposure and the Section 10(b) Defendants' statements of exposure ($13 million and impairment (none)).

First, the Section 10(b) Defendants were the most senior executive officers of RAIT (¶¶46-48) and the subject of the fraud involved RAIT's core business (¶¶3, 56-61). Indeed, RAIT stated in its public filings that its credit monitoring was "the cornerstone of our investment process (¶132), and the Company's false statements regarding both its "de minimis" "$13 million" exposure (¶250) and its purported compliance with GAAP SFAS 115 concerned the very core of RAIT's business. Courts consistently hold that a strong inference of scienter arises as to a company's most senior executives—including the chairperson, the CEO, and the CFO—where, as here, the subject of the alleged fraud is the company's core business operations. *See, e.g.*, *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 709, 711 (7th Cir. 2008); *In re Immucor Inc. Sec. Litig.*, No. 1:05-CV-2276-WSD, 2006 WL 3000133, at *18 (N.D. Ga. Oct. 4, 2006) (applying *Tellabs* and holding that complaint adequately pled scienter as to Chairman and CEO since "[k]nowledge of facts relating to the core functions of a company can be imputed to a company's key officers"); *In re Campbell Soup Co. Sec. Litig.*, 145 F. Supp. 2d 574, 599 (D.N.J. 2001) (holding that complaint adequately pled scienter as to CEO and CFO and recognizing that "knowledge may be imputed to individual defendants when the disclosures involve the company's core business"); *In re Cell Pathways*, No 99-725, 2000 WL 805221, at *7 (E.D. Pa. June 20, 2000) (recognizing that merely invoking a defendant's title does not suffice, but holding that "where the alleged fraud relates to the core business of the company, knowledge of the fraud may be imputed to the individual defendants").[33]

[33] *In re Tel-Save Sec. Litig.*, No. 98-CV-3145, 1999 WL 999427, at *5 (E.D. Pa. Oct. 19, 1999) (holding that complaint adequately pled scienter as to CEO because "the transaction in which the alleged fraud occurred was central to the corporation's core business"); *In re Aetna Inc. Sec. Litig.*, 34 F. Supp. 2d 935,

The Seventh Circuit decision illustrates this point. In that case, the Seventh Circuit reversed the district court's dismissal of a securities fraud complaint and in a unanimous opinion authored by Judge Posner stated:

> At the top of the corporate pyramid sat Notebart, the CEO. The 5500 and the 6500 were his company's key products. Almost all of the false statements that we quoted emanated directly from him. Is it conceivable that he was unaware of the problems of his company's two major products and merely repeating lies fed to him by other executives of the company? It is conceivable, yes, but it is exceedingly unlikely.

513 F.3d at 711. Because Daniel Cohen, Betsy Cohen, and Jack Salmon were the Company's most senior executives who repeatedly made false statements to investors about the Company's core business operations, the Complaint alleges a strong inference of scienter as to them. In turn, their scienter is imputed to the Company (to the extent that corporate scienter does not already exist based on the fact that the fraud concerned the Company's core business). *See, e.g., Makor Issues & Rights, Ltd.*, 513 F.3d at 709; *Monroe Employees Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651, 688 (6th Cir. 2005) ("The scienter of the senior controlling officers of a corporation may be attributed to the corporation itself." (internal quotation marks and alterations omitted)); *In re Campbell Soup Co. Sec. Litig.*, 145 F. Supp. 2d at 597 ("Numerous courts have recognized that scienter sufficiently pled as to a company's agents may be imputed to the company itself, and that is the case here."). Indeed, RAIT does not dispute that the scienter of its senior executives is imputed to the Company.

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954 (E.D. Pa. 1999) (holding that complaint adequately pled scienter as to company's Chairman and CEO because of their executive positions and the alleged fraud concerned company's core operations); *Epstein v. Itron*, 993 F. Supp. 1314, 1326 (E.D. Wash 1998) ("[F]acts critical to a business's core operations or a crucial transaction generally are so apparent that their knowledge may be attributed to the company and its key officers."), *abrogated on other grounds by In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 974 (9th Cir. 1999).

Second, a strong inference of scienter arises from the Section 10(b) Defendants' access to information that contradicted their public statements during the Class Period. As alleged, Betsy Cohen, Daniel Cohen, and Jack Salmon sat on the Company's Management Investment Committee, and Betsy Cohen and Daniel Cohen also sat on the Company's Trustee Investment Committee. ¶¶132, 317. Through those committee memberships and otherwise, Betsy Cohen, Daniel Cohen, and Jack Salmon told investors that they had access to a range of "inside" and other information concerning the Company's borrowers. ¶¶131-32 (quoting RAIT's 2006 Form 10-K, which asserts that the Investment Committee considers a "detailed credit analysis," conducts "extensive due diligence," reviews a "quantitative analysis" and a "credit write-up," and performs "ongoing surveillance," and does so even more closely for a company on one of their "credit watch lists"); *see also* ¶275 (quoting Daniel and Betsy Cohen telling investors that they "carefully" and "constantly" monitored the financial condition of "all" the Company's borrowers).

Thus, the Section 10(b) Defendants knew or should have known that their public statements regarding RAIT's credit exposure and compliance with GAAP were false. *Compare*, *e.g.*, ¶¶249-50, 272-75 (assuring investors of a de minimis $13 million exposure) *with* ¶94 (listing impaired companies to which RAIT was exposed—totaling hundreds of millions of dollars) *and* ¶¶82-111, 234-43, 251-55, 260-66, 277-86, 309 (listing serious negative cash flow and liquidity events suffered by RAIT's borrowers, and describing declining market conditions generally). Indeed, most of these facts were publicly available and could easily have been reviewed (and certainly should have been reviewed) by the Section 10(b) Defendants who, unlike investors, knew the identities of RAIT's TruPS borrowers. ¶¶2, 297. The Section 10(b)

Defendants' admitted access to information that contradicted their public statements gives rise to a strong inference of scienter under applicable law. As the Second Circuit stated:

> [S]ecurities fraud claims typically have sufficed to state a claim based on recklessness when they have specifically alleged defendants' knowledge of facts or <u>access to information contradicting their public statements</u>. Under such circumstances, defendants knew or, more importantly, should have known that they were misrepresenting material facts related to the corporation.

Novak v. Kasaks, 216 F.3d 300, 308 (2d Cir. 2000) (emphasis added). *See also Florida State Bd. of Admin. v. Green Tree Fin.* Corp., 270 F.3d 645, 665 (8th Cir. 2001) ("One of the classic fact patterns giving rise to a strong inference of scienter is that defendants published statements when they knew facts or had access to information suggesting that their public statements were materially inaccurate"); *In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 68, 76 (2d Cir. 2001) (holding that scienter was properly pled where defendants admitted that the issue of the company's "exposure is one that gets considerable management attention"); *In re Campbell Soup Co. Sec. Litig.*, 145 F. Supp. 2d at 599 (holding that scienter was adequately pled where complaint alleged "specific circumstances under which Defendants . . . had access to and received information about the sales efforts and the related accounting practices," and citing *Novak*).

This conclusion applies with equal force to the Section 10(b) Defendants' statements regarding RAIT's financial statements, such as the Company's TruPS valuations and compliance with GAAP provisions SFAS 115, as well as their oral statements regarding the Company's exposure. *See e.g.*, *In re Scottish Re Group Sec. Litig.*, 524 F. Supp 2d 370, 385 (S.D.N.Y. 2007) (finding strong inference of scienter supported by defendants' knowledge of applicable GAAP through repeated publication of the standard in the company's financial statements). For example, in *Florida State Bd. of Admin. v. Green Tree Fin. Corp.* (hereinafter "*Green Tree*"), the Eight Circuit sustained a securities fraud claim against a company that had substantial subprime exposure and a large securitization business. 270 F.3d at 648. Similar to RAIT, Green Tree "rose to prominence by pioneering the securitization of manufactured housing loans, which means that it pooled large numbers of these loans and put them into a trust, which sold securities for which the loans served as collateral." *Id.* Green Tree also retained the first-loss portions of its securitizations and carried those interests on its balance sheet, just like Taberna and RAIT. *Id.* at 649.

The complaint alleged that Green Tree and certain of its officers violated Section 10(b) by overvaluing its retained interests and understating its loss reserves through the use of inaccurate prepayment assumptions. *Id.* at 649-50. The complaint pled that the defendants knew or should have known that the company's financial statements were false because they allegedly monitored the prepayment rates underlying their accounting assumptions. *Id.* The complaint further alleged that the defendants refused to divulge the prepayment assumptions they used to value their interests—just as the Section 10(b) Defendants here refused to divulge the identities of the Company's borrowers. *Id.* Green Tree ultimately took a large write-down to the value of its retained interests in its securitizations, similar to the write-down that RAIT eventually took on its TruPS portfolio. *Id.* at 650. The District Court for the District of Minnesota dismissed the complaint for failure to plead scienter. The United States Court of Appeals for the Eight Circuit reversed unanimously. *Id.* at 648.

Just like the Section 10(b) Defendants here, the *Green Tree* defendants advanced "fraud by hindsight" and "mismanagement" arguments in support of their motion to dismiss. *See, e.g.*, RAIT Mem. at 12 n.8, 26, 37. Specifically, they argued that the valuation of assets and the setting of reserves within the context of subprime-related securitizations required complex accounting determinations and the use of judgment, so that "even very large mistakes could fall within the realm of good faith." *Id.* at 666. Relying on the complaint's allegations that the defendants had access to facts that arguably contradicted their accounting judgments, the Eighth Circuit held that the complaint gave rise to a strong inference of scienter with respect to asset valuation:

> Undoubtedly, <u>the accounting issues are complex; whether they were handled within the parameters of good faith decision-making or whether the decisions amounted to recklessness will surely be the focus of any trial in this case. We will not prejudge that issue. But neither the district court, nor we, can conduct a battle of experts on a motion to dismiss</u>. Rather, we must assume the truth of the allegations pleaded with particularity in the complaint. The strong-inference pleading standard does not license us to resolve disputed facts at this stage of the case.

Id. (emphasis added). Thus, *Green Tree* supports a finding of scienter here.

In addition, the reaction of analysts upon learning of RAIT's disclosures at the end of the Class Period also demonstrates the Section 10(b) Defendants' scienter with respect to violations of GAAP and misstatements of RAIT's financial results. One analyst stated that it was now clear RAIT "would lose significant value in some of their CDOs—a <u>likely scenario given the toxic credits that [RAIT] is exposed to</u>." ¶302. The identity of these "toxic credits" were known to the Section 10(b) Defendants (but concealed from investors) throughout the Class Period. ¶¶2, 297. Another analyst told Daniel Cohen that "You can't be serious, here" and questioned why the Company "didn't mark anything the last quarter. You thought at the end of Q-2 that everything was fine? In the homebuilders, with WCI, with Beazer, with Tarragon, you thought it was fine with the sub-and-mid-prime mortgage lenders? What am I missing?" ¶298. This reaction by outsiders first learning of this information raises a strong inference that RAIT's insiders, who had long known the identity of RAIT's "toxic credits" (including its exposure to Beazer, Tarragon and WCI) acted with scienter. *See Scottish Re*, No. 06 Civ. 5853 (SAS), 2007 WL 3256660, at *14 (finding strong inference of scienter based on "contemporaneous circumstances" that defendants knew or should have known to take into account"); *Argent Classic Convertible Arbitrage Fund L.P. v. Rite Aid Corp.*, 315 F. Supp. 2d 666, 685 (E.D. Pa. 2004) (reasoning that there is a "strong inference" of scienter when "accounting practices [are] so flawed . . . and so blatant that outsiders perceived them almost immediately").

Third, the Section 10(b) Defendants had an indisputable duty to monitor RAIT's credit exposure. This duty was created by, among other things, their repeated statements to investors that they were diligently monitoring this information. It is well-established that a defendant's failure to check information that he or she had a duty to monitor gives rise to a strong inference of scienter. *See, e.g.*, *Novak*, 216 F.3d at 311 (holding that strong inference of scienter arises when defendants "failed to check information they had a duty to monitor"). The Section 10(b) Defendants repeatedly assured investors that they closely monitored the financial condition of the Company's borrowers, with an emphasis on assessing those borrowers' "cash flow" and "liquidity and capital." ¶132; *see also* ¶¶3,116, 125, 131-32, 250, 256, 275, 297. Given these repeated and specific assurances—some of which were issued in direct response to analysts' inquiries about the health of those borrowers (¶¶250, 275)—the RAIT Defendants had a duty to check available information about the creditworthiness of the Company's TruPS counterparties. This duty was particularly important to investors because, as noted above, those shareholders could not check this information themselves. *See, e.g.*, ¶¶2, 81, 94, 297. And as the Complaint alleges in detail, an array of information available to the Section 10(b) Defendants strongly indicated that RAIT's borrowers were experiencing severe cash flow and liquidity problems throughout the Class Period that impaired their ability to service their TruPS. *See* ¶¶82-111, 234-43, 252-55, 260-66, 277-86, 309. To the extent that the Section 10(b) Defendants ignored or otherwise failed to check this information, their failure gives rise to a strong inference of scienter. *In re Scholastic Corp. Sec. Litig.*, 252 F.3d at 77 (finding strong inference of scienter because, "[d]espite public statements that considerable management attention was given to monitoring returns, Scholastic issued no warnings or corrections"); *Rothman v. Gregor*, 220 F.3d 81, 91 (2d Cir. 2000) (holding that strong inference of scienter arises from "a reckless failure to follow an announced policy"); *Novak*, 216 F.3d at 311; *Montoya v. Mamma.com*, No. 05 Civ. 2313, 2006 WL 770573, at *6 (S.D.N.Y. Mar. 28, 2006) ("Plaintiffs may posit the requisite inference of fraud by alleging that defendants failed to check information they had a duty to monitor." (internal quotation marks omitted)); *In re atlas Air Worldwide Holdings, Inc. Sec. Litig.*, 324 F. Supp. 2d 474, 491 (S.D.N.Y. 2004) ("The Individual Defendants were not entitled to make statements concerning the company's financial statements and ignore reasonably available data that would have indicated that those statements were materially false or misleading.").

<u>Fourth,</u> the size of the permanent impairments that RAIT took in the third quarter of 2007 further supports a strong inference of scienter as to the Section 10(b) Defendants. On November 5, 2007, RAIT reported an admittedly "significant" permanent impairment charge of $247 million on its TruPS portfolio as of September 30, 2007. ¶305. RAIT also announced that as of that date, five TruPS issuers had defaulted on $315 million worth of TruPS, and that, in total, RAIT had placed $362 million of loans on non-accrual status. *Id.* Further, Daniel Cohen admitted that the Company still had $100 million of exposure remaining in Taberna II through VII and another $275 million of exposure in Taberna VIII and IX, for a total of $622 million in actual impairments and remaining "homebuilder and mortgage" exposure. ¶¶296, 305-06.

These figures are entirely disproportionate to the purported $13 million in exposure to subprime-related companies and homebuilders that Daniel Cohen and Betsy Cohen stated as late as May of 2007 as well as these Defendants (false) statements that they did a "cream of the crop" approach to lending were "dedicated to pristine credit" (¶349), took a "conservative stance" to exposure (¶250), that "our credit quality remains strong" and "market conditions are favorable for our business." (¶272). The impairment charge of $247 million that RAIT took in November of 2007 is <u>nineteen times larger</u> than the total exposure of $13 million that Daniel Cohen and Betsy Cohen claimed the Company had just a few months earlier. *See* ¶¶272-75. The total of $622 million in permanent impairments and remaining exposure is approximately <u>forty-eight times larger</u> than the $13 million in exposure that the Cohens claimed RAIT possessed in February and again in May of 2007. The size of these write-downs and the sharply revised estimate of remaining exposure further support a strong inference of scienter. *See, e.g., Green Tree*, 270 F.3d at 666 ("Additionally, the sheer size of the $390 million write-down adds to the inference that defendants must have been aware the problem was brewing."); *In re Scholastic Corp. Sec. Litig.*, 252 F.3d at 73 (holding that $13 million pre-tax special charge "lends yet more support to the notion that defendants had knowledge of" allegedly concealed facts); *Rothman*, 220 F.3d at 92 (holding that "magnitude of this write-off" of $73.8 million "supports [plaintiff's] claim of fraudulent intent" because it was highly unlikely that defendants "suddenly realized" such a charge was necessary); *In re WorldCom, Inc. Sec. Litig.*, 294 F. Supp. 2d at 416 (holding that "enormous amounts at stake," especially combined with defendant's "active[] monitoring," supported strong inference of scienter); *In re Baan Co. Sec. Litig.*, 103 F. Supp. 2d 1, 21 (D.D.C. 2000) (noting that "the magnitude of the error can play a role" in determining scienter, and holding that scienter was pled adequately). *Cf. In re Aetna Sec. Litig.*, 34 F. Supp. 2d at 953, n.10 (noting that short time period between allegedly false statements and revelation of truth can support strong inference of scienter). For all those reasons, the allegations of the Complaint, considered collectively, give rise to a strong inference of recklessness as to the Section 10(b) Defendants.

The Section 10(b) Defendants respond by strategically ignoring the Complaint's allegations of recklessness. *See* RAIT Mem. at 37-38. While they claim that the Complaint fails to allege "facts" establishing their recklessness (RAIT Mem. at 37), these facts are alleged throughout the Complaint and they do not go away simply because Defendants ignore them. Defendants first argue that the Complaint pleads their "knowledge of the business" in generic fashion that does not satisfy the PSLRA. *Id.* at 37. But this ignores the Complaint's allegations, set forth above (among others), regarding how the Section 10(b) Defendants (i) repeatedly told investors that they closely monitored the Company's borrowers, and (ii) repeatedly personally assured investors regarding RAIT's purported "de minimis" exposure and our statements (¶¶250, 272-75), (iii) how these Defendants were on the Management Investment Committee and Trustee Investment Committee (¶¶132, 317), and (iv) how the monitoring of the Company's credit portfolio was, as the Section 10(b) Defendants themselves told RAIT's investors, "the cornerstone" of RAIT's business. (¶¶131-32) These allegations are not generic "boilerplate". They are powerful, compelling and unique—they describe specific and repeated assertions of active management, and explain how that gave the Section 10(b) Defendants unique access to information concerning the deteriorating financial condition of the Company's borrowers. *See Tellabs*, 513 F.3d at 711.

In a rehash of an earlier (flawed) argument that the Section 10(b) Defendants invoked to contend that the Complaint fails to allege a misstatement, the Section 10(b) Defendants claim that Lead Plaintiff "cannot rely on later events" to show scienter. RAIT Mem. at 37. But—as set forth above—the Complaint pleads numerous contemporaneous facts as to specific borrowers and the marketplace generally, which rendered false the Section 10(b) Defendants' statements about "de minimis" exposure and their accurate application of GAAP in valuing the Company's TruPS portfolio. *See Mississippi Pub. Employees' Ret. Sys.*, 523 F.3d at 90-91 (limiting fraud-by-hindsight doctrine to cases "where there is no contemporaneous evidence at all that defendants knew earlier what they chose not to disclose until later," and rejecting fraud by hindsight argument in that case because the "company said it had been monitoring, analyzing, and investigating the problem"); *Green Tree*, 270 F.3d at 666 (concluding that "[w]hether defendants could have believed during the class period that the reserves were an adequate response is a question of fact that cannot render the complaints inadequate, lest the heightened pleading requirements of the Reform Act replace the function of a trial"). In any event, contrary to the RAIT Defendants' claims, the size of a post-class period write-off is relevant to the scienter inquiry. *See, e.g.*, *In re Scholastic Corp. Sec. Litig.*, 252 F.3d at 73 ("As stated earlier, post-class period data may be relevant to determining what a defendant knew or should have know during the class period."); *Novak*, 216 F.3d at 300 ("For one thing, the complaint provides specific facts concerning the Company's significant write-off of inventory directly following the Class Period, which tends to support the plaintiffs' contention that inventory was seriously overvalued at the time the purportedly misleading statements were made."); *Rothman*, 220 F.3d at 92 (holding that size of post-class period write-off supports strong inference of scienter).[34]

[34] The Section 10(b) Defendants' citation to *Winer Family Trust v. Queen*, 503 F.3d 319 (3d Cir. 2007) does not advance their cause. RAIT Mem. at 37-38. *Winer* is readily distinguishable from the facts alleged here—indeed, the allegations in *Winer* were particularly weak and failed to allege any contemporaneous facts that, if proven, gave any suggestion that defendants knew their statements were false when made. Rather, the complaint there alleged facts showing that the *Winer* defendants became aware of facts contradicting their statements—if at all—only <u>after</u> they had issued the challenged statements. *See* 503 F.3d at 332-33 (noting that "higher estimate" arguably contradicting defendant's statement became available "a week after [defendant] made the challenged statements," that renovations potentially contradicting defendant's statements did not begin "until weeks after [defendant] challenged statements"). By contrast, in this case, the Complaint alleges particularized facts concerning the

2. The Complaint's Detailed Allegations Adequately Plead That **Defendants Had The Motive And Opportunity To Commit Fraud**

A strong inference of scienter also arises from the unique and powerful motives that the Section 10(b) Defendants had to commit fraud. As set forth below, the Complaint's motive allegations are detailed and compelling. When viewed in their entirety, they portray unique circumstances giving rise to a highly unusual and particularly powerful set of motives that are not often present in a public corporation. The complex web of family relationships, the desire to save Taberna after its failed IPO (and unsuccessful search for an independent merger partner), the huge amount of fees and other benefits accruing to the Cohens' other companies that dealt with RAIT, the large amount of personal compensation inuring to the Section 10(b) Defendants, and a need to raise an enormous amount of capital from public investors are facts that, when viewed "holistically" (as required by *Tellabs*) plainly give rise to a strong inference of scienter particularly when viewed, as required, in conjunction with the allegations of recklessness). *See, e.g.*, ¶¶1-11, 61-65, 73-79, 316-32.

Recognizing the collective strength of these allegations, the Section 10(b) Defendants attempt to scrutinize each allegation in isolation and explain why—standing alone—that allegation is purportedly insufficient to raise a strong inference of scienter. *See* RAIT Mem. at 32-35. This approach is not permitted in the wake of the *Tellabs* decision, in which the Supreme

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deterioration of the Company's borrowers, and the real estate market generally, that were known to the Section 10(b) Defendants before and at the time of their statements. *See supra*. Moreover, there were numerous other "exculpatory" facts alleged in the *Winer* complaint, which is not the situation here. 503 F.3d at 328 (noting that "the most plausible inference from these events was that after the March 28, 2002 walking tour, Pennexx realized that the cost of renovation would be more expensive than previously estimated"). These unique facts, *i.e.*, defendants' access to new information during the brief time between their allegedly false and corrective statements, gave a powerful innocent explanation to defendants' claims that they updated their statements as soon as new information became available through the walking tour. *Id.* at 328. Here, however, the Section 10(b) Defendants repeatedly issued false statements for more than a year, during which time they claimed to have continuously monitored the Company's borrowers, but never revised, updated, or corrected their false statements.

Court held that courts must determine "whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard." *Tellabs*, 127 S. Ct. at 2509 (second emphasis added). The Complaint's motive allegations, accepted as true and viewed holistically, raise a strong inference of scienter.

The Complaint alleges that Betsy Cohen's decision to merge RAIT with her son's Company (Taberna) was done in order to save Taberna from stagnation. ¶¶5, 9-11, 61-65, 319. This merger was Taberna's only option following the collapse of its planned IPO—due to the severely deteriorating market conditions in the real estate industry between November 2005 and April 2006—and Taberna's inability to identify a single independent public company that would merge with Taberna in these conditions. ¶¶61-65. The merger between RAIT and Taberna fundamentally altered RAIT's business model and exposed the Company to significant new (undisclosed) risk, but allowed Taberna to access the public securities markets and raise hundreds of millions of dollars from investors. ¶¶94, 319. The Complaint alleges in detail that the Section 10(b) Defendants were motivated to conceal the true extent of RAIT's exposure to declining real estate markets so that the Company could complete an aggressive series of public offerings raising $855 million in capital. ¶¶5, 8-11, 57-61, 319. If the impaired credits in RAIT's TruPS portfolio had been disclosed, these offerings would have failed and the Company's CDO business would have been reduced to a stagnant pool of fixed-income assets—the death knell for a CDO operation. ¶61.

Courts routinely hold that motive allegations far less compelling than these raise a strong inference of scienter. For instance, in *In re Res. Am. Sec. Litig.*, plaintiffs based their scienter argument entirely on the defendants' desire to inflate the price of the company's stock in advance of a <u>single</u> $112 million public offering. No. CIV. 98-5446, 2000 WL 1053861, at *6 (E.D. Pa. July 26, 2000). Upon viewing the complaint's allegations "in the light most favorable to plaintiffs," the court "conclude[d] that the motive alleged—that is, the desire to raise capital by means of a secondary public offering—gives rise to 'strong inference' of scienter." *Id.*

Likewise, in *In re Ibis Tech. Sec. Litig.*, the complaint alleged that defendants failed to properly record impairment charges under FAS 144, which is similar to SFAS 115, and that defendants undertook a single public offering for approximately $11 million to raise cash necessary to fund their ongoing business operations. 422 F. Supp. 2d 294, 303 (D. Mass. 2006). The court held that the motive allegation, "*i.e.*, the upcoming public offering," *id.* at 316, raised a strong inference of scienter, as follows:

> Here, the plaintiffs have alleged that the defendants were motivated to delay the timing of the impairment charge in order to artificially inflate Ibis' stock price and successfully complete the October 2003 stock offering, which was necessary to ensure that Ibis would not run out of cash and could fund ongoing operations. Because, as plaintiffs have alleged, Reid [the CEO] was privy to confidential and proprietary information concerning Ibis' operations, financial condition, and present and future business prospects, it can be inferred that Reid understood the significance of the stock offering to Ibis' future and therefore to his own position as head of the company. Accordingly, the plaintiffs have alleged facts supporting an inference that Reid stood to benefit from the alleged fraud and providing additional evidence of scienter.

Id. at 317.

The Complaint here alleges that (i) on the heels of a failed IPO by a family-owned company (Taberna) (¶¶62-65); (ii) Daniel Cohen's mother agreed to merge her public company with Taberna (even though the IPO failed because of declining market conditions and no other public company would merge with Taberna) (*id.*); (iii) immediately following the merger RAIT undertook three offerings within six months to raise <u>$855 million</u> (¶¶5, 319); (iv) these offering saved Taberna from stagnation (¶¶61, 63, 319); and these offerings were completed in the face of deteriorating market conditions and on the strength the Section 10(b) Defendants' materially false assurances to investors that RAIT had no exposure to these conditions ¶¶82-111, 234-43, 250-55, 260-66, 272-86, 309. Just eighteen business days after the last offering was complete, RAIT announced a massive write-down that stunned investors and analysts. ¶¶291-302. Contrary to the Section 10(b) Defendants' arguments, these allegations are not "nothing but 'corporate' or 'business' goals [that] fail to give rise to any inference of scienter." RAIT Mem. at 32. Rather, these are unique and compelling facts that do not have ready parallels with other public companies.

The strong inference of scienter raised by these facts finds further support in the comments of former RAIT employees cited in the Complaint. A former President of RAIT, who left the Company in late 2006 (CW5), stated that the reaction to the Taberna merger inside RAIT was "you've got to be kidding" and that everyone knew "there was a lot of incestuous stuff going down," all of which was kept "very close to the vest." ¶319. Another confidential witness, CW4, a former Senior Vice President who worked at RAIT for three years and left in June 2007, stated that the Taberna acquisition was nothing more than "a mother helping her son" and "the whole thing reeks" of nepotism. ¶¶316, 319. This witness said that the Taberna transaction was known inside RAIT to be extremely "risky" but was done by Betsy Cohen to bail out her son. And CW3, a former minority partner of Cohen Bros. from 2000 through 2006, stated that Daniel Cohen was "extremely unscrupulous, very unethical" and engaged in a "lot of inter-dealings" between Cohen Bros. and RAIT. ¶319.

The Complaint also details other specific motive allegations, including (1) the Section 10(b) Defendants' desire to fund the Company's CDO business so that the Cohens could continue to receive tens of millions of dollars in fees from related-party transactions (¶¶73-79);

(2) the Section 10(b) Defendants' desire to exchange relatively valueless Taberna stock into much more valuable RAIT stock (¶327); (3) the Section 10(b) Defendants' desire to receive overly-generous executive compensation packages (¶¶327-32); and (4) the Section 10(b) Defendants' desire to inflate the value of stock serving as collateral for Daniel Cohen's personal $10 million line of credit. ¶326.

The Complaint also contains detailed allegations setting forth how numerous entities related to the Cohens reaped millions of dollars in fees and benefited in a concrete way from the continuation of RAIT's CDO business. *See* ¶¶73-79. For instance, Cohen Bros. (which was co-founded by Daniel Cohen and his brother Jonathan, and 87% owned by Daniel Cohen, who also served as its CEO) and its related companies received millions of dollars in fees for various "services" between Cohen Bros. and RAIT. Daniel Cohen used Cohen Bros., and its wholly-owned subsidiary Cohen & Company, to originate and structure the TruPS securities that RAIT used to collateralize its CDOs. Cohen & Company made at least <u>$54 million</u> in fees by providing these services to RAIT (¶75) and benefited directly by the additional CDO collateralizations that RAIT was able to conduct only because of the funding it received from the public offerings discussed herein. *See* ¶¶5, 61-65, 319. Cohen & Company shared physical locations with RAIT at 2929 Arch Street in Philadelphia, and the Complaint details millions of dollars in additional fees and benefits that the Cohens and their related companies generated through their association with RAIT, including:

- RAIT purchased more than $26 million in bonds issued in a securitization managed by Cohen & Company (¶78(a));
- Cohen & Company entered into a non-compete agreement with RAIT, which RAIT valued as a $9.25 million asset on its balance sheet (¶78(b));
- For the six months between December 31, 2006 and June 30, 2007, RAIT paid Cohen & Company more than $6.5 million in "origination fees" for structuring RAIT's CDO securitizations (which, in turn, were funded by the

money that RAIT raised from public investors as a result of the Section 10(b) Defendants' false and misleading statements) (¶78(c));

- RAIT paid Cohen & Company nearly another $1 million for unspecified "services" and "lease payments" from December 31, 2006 through June 30, 2007 (¶¶78(d), (e)); and
- RAIT maintained a very close relationship with The Bancorp, Inc., a commercial bank where Betsy Cohen is the CEO and director, and Daniel Cohen is the Chairman. RAIT maintained over $100 million in cash at Bancorp and paid Bancorp more than $250,000 in "technical support" and "rent." ¶79.

When considered collectively as required by *Tellabs*, these motive allegations are unique and compelling and are plainly sufficient to raise a strong inference of scienter sufficient to deny a motion to dismiss. *See In re JPMorgan Chase & Co. Sec. Litig.*, No. 06-C-4674, 2007 WL 4531794, at *8 (N.D. Ill. 2007) (holding that defendant's desire to "increase his executive compensation and guild his reputation" were "important considerations," that, when viewed collectively with the complaint's other allegations, gave rise to a strong inference of scienter); *Sekuk Global Enter. v. KVH Enter.*, No. Civ. A 04-306 ML, 2005 WL 1924202, at *14-15 (D.R.I. 2005) (holding that desire to inflate stock in advance of a single $51.5 million offering, "when read along with the rest of the complaint," gave rise to a strong inference of scienter); *In re Hamilton Bankcorp, Inc. Sec. Litig.*, 194 F. Supp. 2d 1353, 1358 (S.D. Fla. 2002) (recognizing the desire to complete an offering as a motive upon which to base an inference of scienter, along with other factors).[35]

[35] As pointed out above, the Section 10(b) Defendants respond to these allegations by improperly addressing them in isolation. RAIT Mem. at 33. The error of this approach is amply demonstrated by the convoluted argument that these Defendants make in an attempt to escape the compelling inferences of motive that flow from the insider and related-party nature of the benefits they and their companies received from the fraud at RAIT (which they perpetrated). Specifically, they argue first that RAIT was "simply conducting business" and, if this business "results in fees paid to entities who assist it [namely, Cohen & Company] it also cannot be evidence of motive to commit fraud." RAIT Mem. at 33. This argument over-reaches, and is not consistent with reading all plausible inferences from the Complaint in favor of Lead Plaintiff. Not surprisingly, the only case that Defendants cite involves underwriting fees

The Section 10(b) Defendants respond by arguing that, despite all of the above, the Court cannot recognize an inference of scienter because the Complaint does not allege insider selling. *See* RAIT Mem at 36. The argument fails. To begin with, it misstates the law. As the *In re Res. Am. Sec. Litig.* court recognized, where, as here, the plaintiff does not initially base any of his motive allegations on insider trading, then, quite naturally, "a lack of insider trading does not serve to negate the strong inference of scienter." No. CIV. 98-5446, 2000 WL 1053861, at *7; *see also Green Tree,* 270 F.3d at 663 ("In this case, however, the investors do not rely on allegations of insider transactions, but on other motives, such as the hope of huge bonuses, that are not directly undermined by [defendants'] abstention from trading."); *In re Ibis Tech. Sec. Litig.*, 422 F. Supp. 2d at 317 ("The absence of insider trading does not preclude an inference of scienter, especially where the plaintiff alleges that the defendant stood to benefit from the fraud [by way of the offerings]."). [36]

Moreover, as alleged in the Complaint, the typical motivation for insider selling does not exist within the context of a real estate investment trust, such as RAIT. As alleged, RAIT was legally required to pay out 90% of its income as dividends to its shareholders. ¶56. Further, during the Class Period, these dividend payments consistently escalated, providing the Section 10(b) Defendants with millions of dollars in regular income. ¶¶321-25. Had they sold their

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paid to CSFB by an issuer—not underwriting and other fees in the tens of millions of dollars paid to an investment company (Cohen & Company) that is owned and controlled by the same family that controls the issuer (as alleged here). *See id.* at 33.

[36] And other courts have consistently rejected the notion that an absence of insider selling defeats an inference of scienter. *P.R. Diamonds, Inc. v. Chandler*, 364 F.3d 671, 691 (6th Cir. 2004) ("[W]e have never held that the absence of insider trading defeats an inference of scienter."); *Hanon v. Dataproducts Corp.*, 976 F.2d 497, 507 (9th Cir. 1992). Even more fundamentally, the Supreme Court made quite clear in *Tellabs* that no economic motive is required to create a strong inference of scienter, let alone a motive as specific as insider selling. *Tellabs*, 127 S. Ct. at 2511 (holding that defendant's "lack of pecuniary motive" is not dispositive because allegations must be considered collectively).

stock, the RAIT Defendants would have forfeited that substantial income. Their desire to retain this income stream—which, again, is a unique factor present in this context and not present in most other cases—explains why insider selling is far less likely to occur under these circumstances, and why its absence is of no import to the Court's scienter inquiry. Indeed, by using $74 million in proceeds from the April 2007 Note Offering to buy back 2.7 million shares, these Defendants benefited from the fraud by increasing their own dividends. *See Tellabs*, 127 S. Ct. at 2511 (holding that defendant's "lack of pecuniary motive" is not dispositive because allegations must be considered collectively).

C. The Complaint Adequately Alleges Section 20(a) Claims For Control Person Liability Against Daniel Cohen, Betsy Cohen And Jack Salmon

Section 20(a) of the Exchange Act provides that any person who "controls" an entity that commits a violation of Section 10(b) is liable as a "control person." 15 U.S.C. § 78t(a). Thus, Section 20(a) establishes only two requirements for a finding of control person liability, "[f]irst, the 'controlled person' must have violated the securities laws . . . . Second, the 'controlling person' defendant in a Section 20(a) claim must have directly or indirectly controlled the person liable for the securities law violation." *PR Diamonds, Inc. v. Chandler*, 364 F.3d 671, 696 (6th Cir. 2004).

Defendants do not, and could not, argue that the Complaint fails to adequately allege their control over RAIT. *See* ¶¶191-92, 413. Rather, Defendants argue that because the Complaint fails to adequately allege a misstatement or that any Section 10(b) Defendant acted with scienter, no underlying Section 10(b) claim is stated against RAIT. RAIT Mem. at 39. Because, as discussed above, the Complaint adequately states a Section 10(b) claim against the Section 10(b) Defendants (which is imputed to RAIT), the Section 20(a) claim in Count VIII should be sustained.

II. THE COMPLAINT STATES CLAIMS UNDER SECTIONS 11, 12(A)(2) AND 15 OF THE SECURITIES ACT

The Complaint alleges claims under Sections 11, 12(a)(2) and 15 of the Securities Act with respect to RAIT's January 2007 Stock Offering and its July 2007 Preferred Stock Offering.[37] These claims are asserted against RAIT, Ellen DiStefano, Betsy Cohen, Daniel Cohen and Jack Salmon (who all signed and controlled the content of the registration statements for the offerings); the Trustee Defendants who signed the registration statements for the offerings; the Underwriter Defendants who underwrote each offering; and Grant Thornton, who consented to the inclusion of its audit opinion for RAIT's financial statements as of December 31, 2006, appearing in the registration statement for the July 2007 Preferred Stock Offering.

A. The Pleading Requirements For Claims Under Section 11 And Section 12(A)(2)

Section 11 imposes a "stringent standard of liability." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 381-82 (1983). Under the "virtually absolute liability provision" of Section 11, plaintiffs do not need to allege that defendants acted with any particular state of mind or plead fraud. *In re Suprema Specialties, Inc. Sec. Litig.*, 438 F.3d 256, 269 (3d Cir. 2006); *see also In re NationsMart Corp. Sec. Litig.*, 130 F.3d 309, 315 (8th Cir. 1997). Similarly, scienter is not an element of claims under Section 12(a)(2). *See Rombach v. Chang*, 355 F.3d 164, 169 n.4 (2d Cir. 2004) ("Neither Section 11 nor Section 12(a)(2) requires that plaintiffs allege . . . scienter"); *In re Immune Response Sec. Litig.*, 375 F. Supp. 2d 983, 1038 (S.D. Cal. 2005)

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[37] Section 11 of the Securities Act provides a private cause of action against issuers, underwriters, auditors and all persons signing a registration statement that "contain[s] an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading." 15 U.S.C. § 77k(a). Section 12(a)(2) provides a similar cause of action against anyone who sells or offers a security by means of a prospectus which "includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77l(a)(2).

(providing that Section 12 "imposes liability without requiring 'proof of either fraud or reliance.'" (citations omitted)). Thus, these claims "place[] a relatively minimal burden on a plaintiff." *Herman & MacLean*, 459 U.S. at 382.

Because fraud is not an element of claims under Sections 11 or 12(a)(2), the pleading of a violation of these provisions requires only "'a short and plain statement of the claim showing that the pleader is entitled to relief'" under Rule 8(a). *See In re WorldCom, Inc. Sec. Litig.*, 294 F. Supp. 2d 392, 406 (S.D.N.Y. 2003), *aff'd*, 366 F.3d 70 (2d Cir. 2004). It is well-established that for a complaint to pass muster under Rule 8(a), a defendant need only be put on notice of the alleged claims. *Tellabs*, 127 S. Ct. at 2507 (noting that for non-fraud claims "the complaint must say enough to give the defendant 'fair notice of what the plaintiff's claim is and the grounds upon which it rests'" (quoting *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 346-47 (2005)); *see also Daou*, 411 F.3d at 1027 ("In a case where fraud is not an essential element of a claim . . . '[a]llegations of non-fraudulent conduct need satisfy only the ordinary notice pleading standards of Rule 8(a)'" (quoting *Vess v. Ciba-Geigy Corp. USA*, 317 F.3d 1097, 1105 (9th Cir. 2003)).

As set forth below, the Complaint easily satisfies these pleading standards, and adequately places Defendants on notice of the nature of the Securities Act claims asserted against them.

B. The Complaint States Securities Act Claims <u>Relating To The January 2007 Stock Offering</u>

On or about January 24, 2007, RAIT issued and sold to the public 11.5 million shares of common stock at $34 per share (this offering is defined in ¶5 of the Complaint and herein as the "January 2007 Stock Offering"). ¶112. The January 2007 Stock Offering took place a little more than one month after the Taberna/RAIT merger closed, and raised over $390 million from public investors. *Id.* The offering was conducted pursuant to the January 2007 Registration

Statement (as defined in ¶113 of the Complaint), which was signed by RAIT's officers and trustees.[38] The Common Stock Underwriter Defendants (as defined in ¶41 of the Complaint) acted as underwriters for the January 2007 Stock Offering.[39] RAIT used the proceeds it received from the offering principally to pay down RAIT's credit lines so that the Company could originate and issue additional CDOs. ¶114.

As alleged in the Complaint, the January 2007 Registration Statement contained numerous false and misleading statements, including statements relating to (i) RAIT's purported compliance with GAAP provision SFAS 115 (*e.g.*, ¶¶117, 341, 344); (ii) RAIT's financial results (¶¶115-19, 342-43); and (iii) RAIT's credit monitoring (¶¶116-19). For instance, the January 2007 Registration Statement made a number of statements regarding RAIT's purported compliance with GAAP and RAIT's reported financial results (including results that were incorporated in the January 2007 Registration Statement through RAIT's Form 8-K/A that was filed with the SEC on December 11, 2006). These statements included:

- An assertion that RAIT's "financial statements are prepared on the accrual basis of accounting in accordance with GAAP." ¶341.

- Statements that RAIT accounted for its investments in debt and equity securities pursuant to SFAS 115, such that those assets were recorded at their fair value. ¶117. (Notably, the January 2007 Registration Statement did not report any impairment charges to RAIT's TruPS portfolio. ¶342.)

- "Selected Unaudited Pro Forma Condensed Combined Financial Data of RAIT and Taberna" for the nine months ended September 30, 2006, reporting net income of approximately $69.2 million, net income available to common shareholders of $61.7 million and investments in securities valued at approximately $4.73 billion. ¶119.

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[38] Defendants Betsy Cohen, Daniel Cohen, Jack Salmon, DiStefano, Brown, Farnesi, Kim, Makadon, Promislo, Quigley, and Stempel signed the January 2007 Registration Statement. ¶113; *see also* ¶¶21-31, 112-20.

[39] The Common Stock Underwriter Defendants are Defendants FBR, Bear Stearns, UBS, RBC, KeyBanc, SNC, and BMO. ¶¶32-38, 41, 112.

See also ¶¶115, 118, 340-45 (listing statements of RAIT's financial results set forth in the January 2007 Registration Statement).

The January 2007 Registration Statement also made a number of statements regarding RAIT's purported credit monitoring, such as that:

- RAIT's "credit underwriting involves an extensive due diligence process that seeks to identify risks related to each proposed investment before an investment decision is made, and, <u>thereafter, to monitor each investment on a continuous basis</u>." ¶116 (emphasis added).

- RAIT had a "disciplined underwriting process <u>and recurring credit analysis</u>." ¶117 (emphasis added).

- RAIT "seeks to manage its credit risk through the underwriting processes . . . <u>and its ongoing credit analysis and monitoring procedures</u>." ¶117 (emphasis added).

From January 10, 2007, when RAIT first filed portions of the January 2007 Registration Statement with the SEC, to January 24, 2007, when RAIT closed on the offering, RAIT's common stock rose from $32.98 to $36.56. ¶113.

The Complaint alleges that RAIT's statements in the January 2007 Registration Statement regarding its purported compliance with GAAP and SFAS 115 were untrue when made. By the time the January 2007 Stock Offering closed, the real estate markets had been in turmoil for more than a year. *See* ¶¶82-84, 110 (detailing severe financial difficulties in the market beginning in late 2005). Moreover, the Complaint alleges in detail that the specific TruPS borrowers in RAIT's portfolio were suffering serious financial difficulties (unbeknownst to RAIT's investors) by the time of the January 2007 Stock Offering. *See* ¶¶96-103, 309 (setting forth significant problems faced by Impac, New York Mortgage, Great Wolf, NovaStar, WCI, Levitt, Orleans, Tarragon and other companies in RAIT's TruPS portfolio). The Complaint alleges how and why the declining market conditions, as well as the performance of RAIT's specific TruPS borrowers, required RAIT to take a permanent impairment pursuant to SFAS 115.

¶¶140-46, 307-315. Thus, the Complaint adequately alleges that RAIT's statements in the January 2007 Registration Statement that it complied with GAAP were materially false. (These points are also discussed in Section I.A.2, *supra*.)

Further, the Complaint alleges that RAIT's failure to take a write-down as required by GAAP resulted in massive overstatements of its net income, net income available to common shares and earnings per share, as reported in the January 2007 Registration Statement. For instance, in the January 2007 Registration Statement RAIT reported net income of $69.29 million, while it was actually <u>negative $177.71 million</u>; its net income available to common shares was not the $61.73 RAIT reported, but <u>negative $185.27 million</u>; and its earnings per share was not the $1.20 reported to investors, but was actually <u>negative $3.61.</u> ¶147. Had RAIT reported its actual results to investors in the January 2007 Registration Statement, the January 2007 Stock Offering could never have been completed.

Finally, as discussed above, the statements regarding RAIT's supposedly "recurring credit analysis" and "ongoing credit analysis and monitoring" were materially false when made. *See e.g.*, ¶¶120, 345. While these statements were intended to reassure investors (in a declining real estate market) that RAIT actively monitored its investments in real estate companies, RAIT did not conduct any meaningful ongoing credit analysis whatsoever. ¶¶3, 84, 94-103, 106-09, 120, 291-306, 309. In fact, RAIT's credit monitoring was so utterly deficient that the Defendants deliberately or recklessly ignored numerous public announcements of serious problems with RAIT's TruPS issuers (the identities of whom were not disclosed to investors) and deteriorating market conditions, such that RAIT did not take <u>any impairments whatsoever until after its TruPS borrowers had already defaulted on $247 million of debt.</u> *See* ¶¶3, 80-84, 94-103, 106-11, 120, 291-306, 309. This was not "monitoring," it was damage control.

These allegations—that material false statements were made in the January 2007 Registration Statement—are all that are needed to state a claim pursuant to Section 11 of the Securities Act against each of RAIT, the Officer Defendants, the Trustee Defendants, and the Common Stock Underwriter Defendants (collectively referred to as the "January Stock Offering Defendants") pursuant to the Rule 8(a) notice pleading standards applicable Securities Act claims. *See, e.g.*, *In re Suprema Specialties, Inc. Sec. Litig.*, 438 F.3d 256, 269 (3d Cir. 2006); *In re Children's Place Sec. Litig.*, No. 97-5021, 1998 WL 35167284, at *6-10 (D.N.J. Sept. 4, 1998).

In response to these well-pled allegations, the January Stock Offering Defendants raise a host of arguments that largely mimic the arguments asserted by the Section 10(b) Defendants in moving to dismiss the Exchange Act claims asserted against them. These arguments fare no better in the context of the liberal pleading rules of the Securities Act than they did under the stricter pleading requirements of the Exchange Act. For instance, the Underwriter Defendants rehash the argument that RAIT's decision (so far) not to restate its financial statements conclusively demonstrates that RAIT's prior period financials were accurate. UW Mem. at 12. This is the same argument that the Section 10(b) Defendants raised (RAIT Mem. at 11) and it should be rejected for the same reasons discussed above. *See Aldridge v. A.T. Cross Corp.*, 284 F.3d 72, 83 (1st Cir. 2002) ("[T]he fact that the financial statements were not restated does not end [plaintiffs'] case . . . . To hold otherwise would [] allow officers and directors of corporations to exercise an unwarranted degree of control over whether they are sued, because they must agree to a restatement of the financial statements."); *see also* cases cited *supra* in Section I.A.2.

Similarly, the Underwriter Defendants imply that RAIT's TruPS portfolio was properly valued because no write-down was required under SFAS 115 until <u>after</u> a default had occurred. UW Mem. at 14. As discussed above, this turns SFAS 115 upside down and finds no support in the language of SFAS 115 (which requires a write-down when full payment is "<u>probable</u>"—not after it has already occurred), in any case law cited by Defendants, or, most importantly, in the well-pled allegations of the Complaint. (Indeed, as discussed above, the fact that RAIT did not even take an impairment charge in the financial period when AHM defaulted on $95 million of debt demonstrates how blatantly Defendants disregarded the requirements of GAAP during the Class Period.)

The Underwriter Defendants and the Trustee Defendants also repeat the Section 10(b) Defendants' arguments that the Complaint's allegations relating to GAAP and financial misstatements are an attempt to plead "fraud-by-hindsight." UW Mem. at 9-17; Tr. Mem. at 15. But the "fraud-by-hindsight" doctrine does not apply where, as here, a Complaint alleges <u>contemporaneous facts</u> supporting allegations of a failure to properly apply GAAP. *See, e.g.*, *Mississippi Pub. Employees' Ret. Sys. v. Boston Scientific Corp.*, 523 F.3d 75, 84 (1st Cir. 2008). The Complaint here alleges numerous contemporaneous facts demonstrating why a write-down was required pursuant to SFAS 115. These include that at least twelve separate TruPS issuers identified by Lead Plaintiff during its investigation faced significant financial and liquidity problems during the Class Period (*see* ¶¶82-84, 94-110, 234-41, 243, 252-55, 260-66, 277-88, 309), and that the industry-wide market was in a meltdown. ¶¶140-59, 307-15. *See, e.g.*, *Novak v. Kasaks*, 216 F.3d 300, 309 (2d Cir. 2000) (cited by the Underwriter Defendants but stating that defendants are "responsible for revealing those facts reasonably available to them" (emphasis added)).[40]

Apparently recognizing that the arguments raised by other Defendants have little merit in the face of the significant negative market and other events occurring after September 2006, the Underwriter Defendants attempt to differentiate themselves by stating that the financial statements included in the January 2007 Registration Statement related only to RAIT's financial condition as of September 30, 2006. UW Mem. at 11-12. The Underwriter Defendants argue that the Complaint does not adequately allege that RAIT had failed to comply with GAAP as of September 30, 2006. In support of this argument, they assert that the Complaint alleges facts that only made it possible, not probable that RAIT's TruPS portfolio was impaired as of September 30, 2006. Thus, because SFAS 115 requires a write-down only when it is "probable" that an asset is impaired, the Underwriter Defendants contend that SFAS 115 did not require RAIT to write-down its portfolio as of September 30, 2006 and therefore the statements in the January 2007 Registration Statement regarding RAIT's financial results and the compliance with GAAP were not false and misleading.[41] UW Mem. at 14-15. This argument has no merit.

To begin with, the Underwriter Defendants' efforts to absolve themselves of all responsibility for events occurring after September 30, 2006 should be rejected. It is well-established that underwriters have an obligation under the securities laws to ensure that all

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[40] As discussed above, the Underwriter Defendants' citations to *In re Acceptance Ins. Cos. Sec. Litig.*, 423 F.3d 899 (8th Cir. 2005) (UW Mem. at 9) is not on point because the complaint in that case relied exclusively on facts that occurred after the publication of the allegedly false statements. Likewise, *Denny v. Barber*, 576 F.2d 465 (2d Cir. 1978), involved a bare-bones complaint that did not even identify what misstatements were alleged to be false and simply alleged that defendants carried loans that were "risky," without further explanation.

[41] Of course, this argument has no relevance to the false statements of credit monitoring in the January 2007 Registration Statement, which the Underwriter Defendants are responsible for.

statements in the offering documents are complete and accurate <u>at the time securities are offered to the public</u> (here, on January 24, 2007). As the SEC stated regarding Section 11:

> Congress recognized that underwriters occupied a unique position that enabled them to discover and compel disclosure of essential facts about the offering. <u>Congress believed that subjecting underwriters to the liability provisions would provide the necessary incentive to ensure their careful investigation of the offering</u>.

In re WorldCom Sec. Litig., 346 F. Supp. 2d 628, 662 (S.D.N.Y. 2004) (citing SEC Release No. 7606A, 63 Fed. Reg. 67174) (emphasis added). In order to ensure that underwriters carried out their important obligations under the securities laws, Congress "imposed upon underwriters the obligation to . . . exercise a high degree of care in investigation and independent verification of the company's representations." *Id.* (citation omitted).

This is because "no greater reliance in our self-regulatory system is placed on any single participant in the issuance of securities than upon the underwriter," as they "function as the first line of defense with respect to material misrepresentations and omissions in registration statements." *Id.* Given its critical role, an underwriter is strictly liable for any false or misleading statements in a registration statement at the time the registration statement becomes effective, unless they can show that:

> after reasonable investigation, [they had] reasonable ground to believe and did believe, <u>at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading</u>

15 U.S.C. § 77k(b)(3)(A) (emphasis added). Thus, the Underwriter Defendants here had a legal obligation to ensure that the statements in the January 2007 Registration Statement were correct and not misleading as of January 24, 2007, when it became effective and securities were offered to the public. It is not enough for the Underwriter Defendants to say that their "due diligence" investigation for the January offering stopped "as of" September 30, 2006 because that was the

date of the last financial statements included in the January 2007 Registration Statement. Rather, the Underwriter Defendants had an obligation to continue investigating and verifying the Company's statements until January 24, 2007. This plainly included the obligation to take into account the continued deterioration of the market and of RAIT's specific TruPS portfolio occurring between September 2006 and January 2007 to determine, among other things, whether the statements contained in the registration statement were misleading. Even if it were true that as of September 30, 2006 GAAP did not require RAIT to take a write-down of its TruPS portfolio (and as alleged in the Complaint, it is not), the Underwriter Defendants had a continuing obligation to ensure that changing market conditions and other factors had not rendered those statements misleading by the time the securities were offered to the public—January 24, 2007.[42]

Moreover, the Underwriter Defendants contention that it was only "possible," not "probable" that an impairment was required as of September 30, 2006 is precisely the sort of fact-based argument regarding the proper application of GAAP that courts routinely reject on a motion to dismiss.[43] Whether an impairment was "possible" or "probable" is a disagreement that simply cannot be resolved in Defendants' favor at the pleading stage. This is particularly true here because the Complaint alleges that Defendants failed to comply with GAAP SFAS 115 as

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[42] The Complaint alleges numerous additional events occurring between September 2006 and January 2007 that the Underwriter Defendants apparently ignored (and wrongly suggest that they were entitled to ignore) in connection with the January Registration Statement. *See, e.g.,* ¶¶82-83, 94-103, 107.

[43] *See, e.g., Florida State Bd. of Admin. v. Green Tree Fin.* Corp., 270 F.3d 645, 666 (8th Cir. 2001); *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1421 (3d Cir. 1997) (compliance with GAAP is a factual question not to be decided on a motion to dismiss); *In re Refco, Inc. Sec. Litig.*, 503 F. Supp. 2d 611, 656-57 (S.D.N.Y. 2007) ("At the motion to dismiss stage, the plaintiffs' assertion that certain practices were not generally accepted must be taken as true." (internal citations omitted)); *In re Ibis Tech. Sec. Litig.*, 422 F. Supp. 2d 294, 315 (D. Mass. 2006) (plaintiffs adequately pled GAAP violations for failure to write-down assets); *In re Aetna Inc. Sec. Litig.*, 34 F. Supp. 2d 935, 956 (E.D. Pa. 1999) (plaintiffs adequately pled GAAP violations by stating "what the alleged unreasonable accounting practices were and how Defendants allegedly distorted their earnings").

of September 30, 2006, and includes facts to support that claim. *See, e.g.*, ¶312 ("RAIT should have booked other-than-temporary impairment charges in its financial statements for September 30, 2006, December 31, 2006, and March 31, 2007."); *see also* ¶¶307-13.[44]

While the Underwriter Defendants suggest that the Complaint contains no allegations relating to problems faced by RAIT's specific TruPS issuers as of September 30, 2006 (UW Mem. at 11-13), they are plainly incorrect. Lead Plaintiff has been able to identify through its investigation twelve separate TruPS issuers to which RAIT was exposed (and no Defendant has disputed that these issuers were in RAIT's portfolio). Obviously, additional TruPS issuers may be revealed in discovery—indeed, it seems a near-certainty given RAIT's subsequent admission that it had a massive $622 million in impairments and remaining exposure as of November 2007. But even when considering just the twelve identified TruPS borrowers, the Complaint alleges severe problems existing as of September 30, 2006 that should have alerted RAIT to the need to take a write-down as of September 30, 2006 (particularly when viewed in conjunction with the disastrous market-wide conditions existing at the time).[45] Given these allegations, the

[44] Even the Underwriter Defendants are forced to concede that the Complaint contains "voluminous allegations regarding more severe financial difficulties encountered in 2006 and 2007 by <u>seventy-eight</u> other companies in the real estate industry, <u>including allegations that some had defaulted on their credit lines or terminated their business operations.</u>" UW Mem. at 16 (emphasis added). They argue, however, that industry-wide factors are not relevant. *Id.* This is incorrect. The Complaint alleges that SFAS 115 required RAIT to evaluate "conditions in the real estate industry" (¶310) and determine whether this "industry-wide crises" was a "short-term circumstances that would quickly dissipate" (¶311). Thus, contrary to the Underwriter Defendants' arguments, conditions in the real estate industry at large are a critical factor under SFAS 115.

[45] These allegations are voluminous and particularized. For instance, the Complaint alleges that as of September 30, 2006, RAIT's specific TruPS borrowers faced significant long-running problems, including (i) **<u>Impac</u>** reported in February 2006 an 80% decline in its net earnings for the fourth quarter 2005 compared to the same period 2004, and it reported a 51% decline in its net earnings for the first quarter 2006 compared to same period 2005, while as of September 30, 2006, Impac experienced a net loss of $127.7 million, compared to net earnings of $126.4 million for the same period 2005, a 200% decline (¶96); (ii) **<u>New York Mortgage</u>** announced in March 2006 a net loss of $8.7 million for the fourth quarter 2005 and a net loss of $5.3 million for the entire year 2005, and as of September 30, 2006, New York Mortgage had barely enough liquid assets to cover its current obligations (¶¶97, 309(e)); (iii) **<u>Great</u>**

Underwriter Defendants will be provided with the opportunity in discovery (which will presumably include expert accounting evidence) to show that an impairment was merely "possible" rather than "probable"—but that dispute cannot be resolved now.

The Underwriter Defendants also argue that the statements in the January 2007 Registration Statement regarding RAIT's supposed "continuous" and "recurring credit monitoring" are not adequately alleged to be false and, if they are, they are not material to investors. UW. Mem. at 17-19. This argument is identical to the argument raised by the Section 10(b) Defendants, and is refuted above in Section I.A.3. As discussed in detail above, RAIT's purported ability to monitor its credit portfolio was a "cornerstone" of RAIT's business model, was repeatedly emphasized by RAIT's senior executives, and the statements regarding RAIT's credit monitoring included in the January 2007 Registration Statement were plainly false when made. *See supra.*[46]

Wolf reported in February 2006 a net loss of $36.1 million for 2005, while in May 2006, it reported a net loss of $0.9 million for the first quarter 2006, and in August 2006, it reported a net loss of $1.4 million for the second quarter 2006 (¶98); (iv) **NovaStar** reported in May 2006 a 33% decline in net income for the first quarter 2006, compared to the same period 2005 (¶99); (v) **WCI** reported in June 2006 that for the first two months of the second quarter 2006, homebuilding orders plunged by 50%, while in August 2006, it announced a 70% decline in net income for the second quarter 2006, compared to the same period 2005, and that its liquid assets plunged from $52.6 million at December 31, 2005 to a mere $2.0 million at June 30, 2006. As of September 30, 2006 WCI had experienced a 73% decline in net income for the third quarter 2006, which it attributed to "dramatically lower demand" and "home cancellations," and its current obligations exceeded its available liquid assets (¶¶100, 309 (a)); (vi) **Levitt** announced in early 2006 a net loss of $660,000 and that it reduced its workforce by 11%, while in August 2006, it reported a net loss for the second quarter 2006, compared to net income for the same period 2005, and as of September 30, 2006, Levitt had experienced a 96% decline in net income for the nine months ended September 30, 2006, and its current obligations were twice as large as its liquid assets (¶¶101, 309(d)); (vii) **Orleans**, as of September 30, 2006, had liquid assets of $30 million and $80 million in short-term obligations (¶309(f)); and (viii) **AHM**, as of September 30, 2006, had short-term obligations in excess of liquid assets (¶309(h)).

[46] Moreover, these statements must be viewed with the "total mix" of information that RAIT made available to investors at the time of the January 2007 Stock Offering, which included, among other things, (i) Daniel Cohen's statements on the June 9, 2006 conference call that there "were no defaults and no risks in terms of our underlying finance structure (¶68), that "we really finance the best and most capable, best capitalized real estate borrowers" (¶70), and that RAIT's deals will be at "higher credit qualities" that

As a fall-back argument, the Underwriter Defendants state that even if RAIT's statements regarding its credit monitoring were "exaggerated," they were "non-actionable puffery" that do not give rise to securities claims. UW Mem. at 19-20. Again, this argument fails entirely in light of the importance that RAIT's own senior executives placed on these statements—repeatedly emphasizing them to investors, including them in RAIT's public filings and describing them as the "cornerstone" of RAIT's business. *See* Section I.A.3, *supra*. It is well-established that affirmative misstatements concerning important business and management practices are actionable. *See Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1094-95 (1991); *Casella v. Webb*, 883 F.2d 805, 808 (9th Cir. 1989) ("What might be innocuous 'puffery' or mere statement of opinion standing alone may be actionable as an integral part of a representation of material fact when used to emphasize and induce reliance upon such a representation."). For example, in *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 282 (3d Cir. 1992), a case involving a higher Rule 9(b) pleading standard, the court found similar statements actionable, stating:

> [W]here a defendant affirmatively characterizes management practices as "adequate," "conservative," "cautious," and the like, the subject is "in play." For example, if a defendant represents that its lending practices are "conservative" and that its collateralization is "adequate," the securities laws are clearly implicated if it nevertheless intentionally or recklessly [or negligently] omits certain facts contradicting these representations. . . . <u>By addressing the quality of a particular management practice, a defendant declares the subject of its representation to be material to the reasonable shareholder, and thus is bound to speak truthfully.</u>

Id. (emphasis added). In short, these false statements were material to investors and should not be dismissed from the case at the pleading stage. *See PMA Capital Corp.*, 2005 WL 1806503, at

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will "<u>allow us to really do a cream-of-the crop approach to lending</u>" (¶70); (ii) RAIT's statements on that call that it focused on "low-risk asset classes" (¶71); (iii) the statements by Betsy Cohen on the November 3, 2006 conference call that RAIT had no exposure to the residential marketplace because "<u>it's totally hedged out</u>" (¶85); and (iv) the statements in RAIT's November 7, 2006 Joint Proxy that "RAIT has an exemplary track record of credit analysis . . . having suffered almost no losses during its history" (¶87).

*2, *16-17 (sustaining Section 11 claim based on, *inter alia*, statement that PMA was "committed to a philosophy of strict underwriting discipline" and focused on "sound underwriting and prudent reserving" where Complaint alleged that the statements were materially incorrect when made); *see also Basic v. Levinson*, 485 U.S. 224, 231, 240 (1988) (a misrepresentation is material when an investor would attach importance to it in making an investment decision).[47]

The Trustee Defendants and the Underwriter Defendants also contend that the Complaint's allegations against them amount to "corporate mismanagement." *See* Tr. Mem. at 5-9; UW Mem. at 20. This argument has no merit whatsoever. Because the Complaint alleges statements that were false in light of contemporaneous facts, it pleads a viable claim under the securities laws, not mismanagement. *See In re Aetna Inc. Sec. Litig.*, 34 F. Supp. 2d, 935, 950 (E.D. Pa. 1999) ("It may be that the problems . . . that Aetna allegedly experienced stemmed from mismanagement. But this is not the focus of Plaintiffs' claim. Rather, Plaintiffs allege that Defendants made material misrepresentations and failed to disclose material facts . . . ."); *Urbach v. Sayles*, Civ. No. 91-1291, 1991 WL 236183, at *4 (D.N.J. 1991) (rejecting defendants' mismanagement argument because "plaintiff's claims rest on allegations of misstatements made by defendants in overstating reported net income and assets by consciously underreserving for

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[47] The Trustee Defendants claim that the Counts asserted against them do not incorporate any language that falls within *Shapiro's* holding. Tr. Mem. at 6. This is not so. Within the allegations incorporated against the Trustee Defendants, the Complaint alleges, among other things, that Betsy Cohen claimed that RAIT's risk was "totally hedged out" (¶85); Daniel Cohen claimed the company had "no risks," financed "the best and most capable, best capitalized real estate borrowers," and will "really do a cream-of-the-crop approach to lending" (¶¶68-70); RAIT's underwriting was "[d]isciplined" and the Company [f]ocus[ed] on low-risk asset classes" (¶¶71); the registration statements falsely asserted that RAIT's underwriting and monitoring procedures were "disciplined," "continuous," of "cornerstone" importance, and designed to ensure the "adequacy of a potential borrower's cash flow, liquidity, and capital," among other superlatives that *Shapiro* holds are actionable (¶¶116, 125, 131-32). *See Shapiro*, 964 F.2d at 282 ("[W]here a defendant affirmatively characterizes management practices as 'adequate,' 'conservative,' 'cautious,' <u>and the like</u>, the subject is 'in play.'" (emphasis added)).

problem loans, and misrepresenting material facts concerning the institution's loan quality, underwriting standards, and monitoring procedures"); *see also Novak*, 216 F.3d at 312 (rejecting defendants' mismanagement argument concerning "the valuation of inventory and the timing or markdowns" because complaint alleged "materially false statements" as to those items).[48]

Finally, the Underwriter Defendants argue that none of the statements in the January Registration Statement could be "materially" false because RAIT included "cautionary language warning investors about the risks associated with Taberna's and RAIT's investments." UW Mem at 20-23. Thus, they claim, the "bespeaks caution" doctrine holds that these statements are immaterial as a matter of law. They are wrong. Courts have long recognized that the bespeaks caution doctrine does not apply to "general risk disclosures in the face of specific known risks." *In re Prudential Sec. Inc.*, 930 F. Supp. 68, 72 (S.D.N.Y 1996). In an oft-quoted passage that applies here, the Court in *In re Prudential Sec. Litig.* stated:

> The doctrine of bespeaks caution provides no protection to someone who warns his hiking companion to walk slowly because there might be a ditch ahead when he knows with near certainty that the Grand Canyon lies one foot away.

Id. at 72. Here, the Complaint alleges that Defendants knew that the market in general and their TruPS borrowers in particular were experiencing severe problems and that a write-down of RAIT's TruPS portfolio was required. Thus, their artfully-crafted disclosures regarding general

[48] The cases that the Trustee Defendants cite in support of their "mismanagement" argument offer no support. Tr. Mem. 7-9. In each of *Vachon v. Baybanks, Inc.*, 780 F. Supp. 79 (D. Mass. 1991), *Lerner v. FNB Rochester Corp.*, 841 F. Supp. 97 (W.D.N.Y. 1993), and *Cole v. Fed. Home Loan Mortgage Corp.*, No. 90-2812, 1991 U.S. Dist. LEXIS 11857 (D.D.C. Aug. 27, 1991), plaintiffs simply failed to allege any specific, contemporaneous facts in support of their claims. And in *Haft v. Eastland Fin. Corp.*, 755 F. Supp. 1123 (D.R.I. 1991), plaintiff's bare-bones 34-page complaint failed to point to any specific misrepresentation or omission. This case plainly asserts securities fraud, not mismanagement, and the Trustee Defendants' argument to the contrary has no merit.

market risk does not render their false statements inactionable (particularly given that Defendants repeatedly told investors that, despite the deteriorating markets, RAIT had no credit exposure.)

Moreover, in the Third Circuit, it is well-established that the bespeaks caution doctrine applies only to forward-looking statements, and not to statements of present fact. *See EP Medsystems, Inc.*, 235 F.3d at 874 ("By its terms, the 'bespeaks caution' doctrine, like the safe harbor provision in the Reform Act, is directed only to forward looking statements."); *see also id.* at 876 (reiterating that "the 'bespeaks caution' doctrine applies only to forward-looking statements"). All of the false statements in the January and July Registration Statements—*i.e.*, the false descriptions of the Company's underwriting and monitoring practices, the false financial statements, and the false statements of compliance with GAAP—are statements of present or historical fact. None of the false statements are forward-looking.

In apparent recognition of this, the Underwriter Defendants attempt to transform these statements of present and historical fact into forward-looking statements by mischaracterizing them as comments on "the future prospects of the TruPS in which RAIT had an interest." *See* UW Mem. at 20. This sleight of hand should be rejected. The false financial statements reported the present value of the Company's TruPS and the false statements of monitoring described the Company's current (and past) practices. Neither of these statements are "forecasts, opinions, or projections." *EP Medsystems, Inc.*, 235 F.3d at 874 (internal quotations omitted). Accordingly, the bespeaks caution doctrine does not apply.

Even assuming the doctrine could apply to the January 2007 Registration Statement (which it does not), the allegedly cautionary passages to which the Underwriter Defendants point do not render the false statements immaterial as a matter of law. The passage cited by the Underwriter Defendants asserts that, "A prolonged economic slowdown, a recession or declining real estate values could impair our and Taberna's investments . . . ." *See* UW Mem. at 21. The Third Circuit already has already held—in a case almost identical to this one—that this exact "cautionary language" is essentially meaningless and does not render immaterial allegedly false statements concerning the adequacy of loss reserves and compliance with GAAP. *See In re Westinghouse Sec. Litig.*, 90 F.3d at 700-01 ("[T]hese statements do not sufficiently counter the alleged misrepresentations, *i.e*., that the defendants knowingly or recklessly misrepresented the adequacy of loan loss reserves and compliance with GAAP.").[49]

In sum, the Complaint adequately pleads Section 11 and 12(a)(2) claims against each of the January Stock Offering Defendants.[50]

C. The Complaint States Securities Act Claims <u>Relating To The July 2007 Preferred Stock Offering</u>

On or about July 5, 2007, RAIT issued and sold to the public 1.6 million shares of Series C Preferred Stock at $25 per share (as defined in ¶5 of the Complaint and herein, the "July 2007

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[49] The Underwriter Defendants cherry-pick general background language from two paragraphs of the 418-paragraph Complaint to argue that the Complaint asserts that RAIT's TruPS became impaired due to "declining real estate values and a rise in interest rates." *See* UW Mem. at 22. Nothing could be further from the truth. As the Complaint alleges in great detail, and as recounted herein, the Complaint asserts that RAIT's TruPs became impaired principally due to specific liquidity and cash flow events that RAIT's borrowers experienced, among other factors.

[50] The January 2007 Stock Offering Defendants fail to address the fact that they had a duty to update and/or correct the misleading statements made in the January 2007 Registration Statement. See ¶397. It is well established that a corporation and its officers have a duty to update material statements "when they became unreliable." *Weiner v. Quaker Oats Co.*, 129 F.3d 310, 318 (3d Cir. 1997). This duty was particularly strong here because of the nearly four month time lag between the date of the offering (January 24, 2007) and the "as of" date of the financial statements included therein (September 30, 2007). While this data was false when issued, it had become even more misleading by the time the January 2007 Stock Offering closed (January 24, 2007) in light of the severe deterioration of the Company's borrowers and the subprime and homebuilder markets generally. *See* ¶¶94-111. Yet the January Stock Offering Defendants never updated this financial information—even though year-end data for 2006 were readily available. Because RAIT and the Defendants never updated any of this misleading financial data—even when in the case of the January 2007 *Offering*, year-end 2006 data were available—they violated their duty to update. *See Weiner*, 129 F.3d at 318. (This same conclusion applies to the July 2007 Registration Statement, which was rendered even more misleading in light of the continued impairment of RAIT's TruPS counterparties and the ongoing industry-wide turmoil. *See* ¶¶252-55, 260-66, 277-86, 288.)

Preferred Stock Offering"). ¶123. The July 2007 Preferred Stock Offering took place a mere eighteen business days before RAIT disclosed its exposure to AHM and allowed the Defendants to raise approximately $40 million from public investors. ¶5. The offering was conducted pursuant to the July 2007 Registration Statement (as defined in ¶124 of the Complaint), which was signed by RAIT's officers and trustees.[51] The Preferred Stock Underwriter Defendants (as defined in ¶42 of the Complaint) underwrote the July 2007 Preferred Stock Offering.[52] RAIT used the proceeds it received from the offering to originate and issue additional CDOs. ¶123.

In support of their motions to dismiss the Securities Act claims relating to the July 2007 Preferred Stock Offering, (1) all Defendants argue that the Complaint fails to adequately identify any actionable misstatements in the July 2007 Registration Statement; (2) Grant Thornton argues that its Audit Opinion was not misstated at the time of the offering; and (3) all Defendants argue that Lead Plaintiff lacks standing to pursue this claim. None of these arguments have merit.

1. The Complaint Adequately Alleges That The July 2007 Registration Statement Was Materially Misleading

As alleged in the Complaint, the July 2007 Registration Statement contained numerous false and misleading statements, including statements relating to (i) RAIT's purported compliance with GAAP provision SFAS 115 (*see, e.g.*, ¶¶130, 136-37); (ii) RAIT's financial results (¶¶126-29, 133-35); (iii) RAIT's credit monitoring (¶¶125, 131-32); and (iv) Grant Thornton's unqualified audit opinion regarding the Company's financial statements for the year ended December 31, 2006 (¶138).

[51] Defendants Betsy Cohen, Daniel Cohen, Jack Salmon, DiStefano, Brown, Farnesi, Kim, Makadon, Promislo, Quigley, and Stempel signed the July 2007 Registration Statement. ¶124. DiStefano claims that she did not sign the July 2007 Registration Statement (RAIT Mem. at 22) but she signed RAIT's 2006 Form 10-K and Form 10-Q for the 2007 first quarter, both of which were incorporated into the July Registration Statement. ¶127.

[52] The Preferred Stock Underwriter Defendants are Defendants FBR, Bear Stearns, SNC, Piper, and Dain Rauscher. ¶¶42, 123.

The July 2007 Registration Statement also included Grant Thornton's false audit opinion for RAIT's financial statements for the year ended December 31, 2006, as follows:

- We have audited the accompanying consolidated balance sheets of RAIT Financial Trust (formerly RAIT Investment Trust) . . . <u>We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States)</u>. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement . . . . <u>In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of RAIT Financial Trust and its subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America</u>.

¶138 (emphases added); s*ee also* ¶¶123-39 (setting forth the false statements in the July 2007 Registration Statement).

Defendants make the exact same arguments challenging the falsity of the July 2007 Registration statement that they make in connection with other false statements alleged in the Complaint. These arguments, including arguments relating to "falsity" and "materiality," "fraud-by-hindsight," a "lack of a restatement," and unsupported assertions that they correctly applied GAAP, are extensively discussed above and should be rejected here for the same reasons. Indeed, given the further severe declines in real estate markets and the problems with RAIT's TruPS borrowers as of July 2007, arguments that statements in the July 2007 Registration Statement are not adequately alleged to be false are particularly strained. *See* ¶¶82-82, 94-103, 107-11, 234-43, 252-55, 309 (describing severe liquidity and cash flow problems suffered by RAIT's borrowers and plummeting mortgage lender and homebuilders markets as of March 31, 2007) & ¶¶82-82, 94-103, 107-11, 234-43, 252-55, 260-66, 277-86, 288, 309 (describing severe liquidity and cash flow problems suffered by RAIT's borrowers and plummeting mortgage lender and homebuilders markets as of July 5, 2007).[53]

The Underwriter Defendants also claim that language in the July 2007 Registration Statement renders immaterial the false statements contained therein pursuant to the "bespeaks caution" doctrine.[54] UW Mem. at 22-23. But the boilerplate language they cite—which, like the language in the January 2007 Registration Statement, vaguely warns of certain unidentified "factors in the residential mortgage market that are beyond our control"—does not suffice to invoke the bespeaks caution doctrine under *In re Westinghouse Sec. Litig.* and other case law. *See* 90 F.3d at 709; *see also id*. at 707 ("Of course a vague or blanket (boilerplate) disclaimer <u>which merely warns the reader that the investment has risks</u> will ordinarily be inadequate to prevent misinformation.").

Moreover, even if this language vaguely alludes to subprime market exposure, any such warning does not render immaterial the false statements contained in the July 2007 Registration

[53] Grant Thornton also contends that the Complaint inaccurately alleges that RAIT's loan loss reserves were taken against its TruPS portfolio, when in fact those reserves were taken against RAIT's investments in "mortgages and loans." GT Mem. at 18 (claiming that RAIT's loan loss reserves were "*not* intended to cover the risk of loss associated with available-for-sale securities" (emphasis in original)). However, as alleged, on the May 1, 2007 conference call, Daniel Cohen told investors that RAIT used its loan loss reserves to hedge its corporate TruPS portfolio, as follows: "On the credit side we had no payment defaults from our TruPS corporate issuers. However, we continue to take a conservative view by providing for loan losses in our residential [portfolio] as the overall balance sheet continues to grow." ¶272. Moreover, Grant Thornton falsely accuses Lead Plaintiff of inaccurately alleging that RAIT's loss reserve was $2.49 million as of December 31, 2006. GT Mem. at 18. Again, however, Grant Thornton is wrong. The Complaint describes "the cumulative loan loss allowance of <u>$5.35 million</u> reported by RAIT on its balance sheet at December 31, 2006." ¶315 (emphasis added). In any event, as alleged, RAIT's reserves were materially and misleadingly understated throughout the Class Period. *Id.* (providing that RAIT's reserve as of December 31, 2006 was merely "0.000001% of the total $11.1 billion in of investments in securities, mortgages and loans that RAIT reported at that date" and that RAIT's reserve as of March 31, 2007 was "only 0.0000009% of the total $12.5 billion in investments in securities, mortgages and loans that RAIT reported at that date"). By setting these artificially low reserves, RAIT avoided a necessary charge against income and mislead investors by communicating that the Company's exposure to impaired debt was virtually non-existent. ¶¶4, 314-15.

[54] As noted above in Section II.B, the bespeaks caution doctrine does not apply because (among other reasons) the false statements in the July 2007 Registration Statement were not forward-looking.

Statement. First, the passage upon which the Underwriter Defendants rely vaguely hints at "one issuer" involved in the subprime market. In fact, as the Complaint alleges, RAIT had at least $96 million of subprime exposure to several different subprime-related borrowers and much more in exposure to impaired homebuilders. (¶94). The supposed "warning" language simply does not reference—let alone actually warn of—such vast and varied exposure. In any event, this supposed "cautionary" language is plainly insufficient to render Defendants' statements inactionable as a matter of law when viewed in the "total mix" of information made available to investors. These include Daniel Cohen's two prior assurances that RAIT had only $13 million of subprime and homebuilder exposure to a single borrower, that no losses were expected, and that any such exposure was "de minimis" (and many other similar statements). ¶¶249-51, 275. Under similar circumstances, the Third Circuit has held that cautionary language does not render a prior false statement immaterial as a matter of law. *See EP Medsystems, Inc.*, 235 F.3d at 878.

2. Grant Thornton's Audit Opinion Was Materially Misstated At The Time Of The July 2007 Preferred Stock Offering

The Complaint alleges that Grant Thornton's unqualified audit opinion regarding the Company's financial statements as of December 31, 2006 was materially misstated because the Company's financial statements were not presented in accordance with GAAP and Grant Thornton's audits were not conducted in accordance with the standards of the PCAOB. ¶¶159-75. The Complaint specifically identifies the standards Grant Thornton failed to follow in connection with auditing the Company's materially overvalued TruPS portfolio and management's (fraudulent) decision not to take a permanent impairment charge with respect to SFAS 115. ¶¶150-59; *see also* ¶¶140-47, 307-15.

While Grant Thornton argues that the Complaint requires further detail to state a Section 11 claim (GT Mem. at 13-25), Lead Plaintiff need only plead that a registration statement contained an untrue representation and/or omission, and that such information was material to investors. *See Daou*, 411 F.3d at 1027-28. Lead Plaintiff is not required to explain why the statements at issue were untrue and material other than in a general fashion:

> Rule 9(b) does not apply to plaintiff's claims of negligence in connection with its section 11 and 12(a)(2) claims. Therefore, defendants' contention that the Complaint fails to provide adequate factual support for the accounting misstatements is unpersuasive. Whether any or all of the aforementioned statements were, in fact, misstatements in violation of GAAP or GAAS is an issue to be determined at a later date and not on a motion to dismiss.

In re Majesco Sec. Litig., No. 05CV3557(PGS), 2006 U.S. Dist. LEXIS 73563, at *15 (D.N.J. Sept. 26, 2006) (emphasis added); *see also Bell Atl.*, 127 S. Ct. at 1969 (holding that the complaint must provide the "grounds upon which [the plaintiff's] claim rests" through factual allegations sufficient to "raise a right to relief above the speculative level" (internal citations omitted)).

Section 11 claims in numerous other cases have been sustained against outside auditors with similar allegations. *See, e.g.*, *In re Metro., Inc. Sec. Litig.*, 532 F. Supp. 2d 1260, 1294-95 (E.D. Wash. 2007) (denying auditor defendant's motion to dismiss Section 11 claim because complaint alleged that auditor approved false financial statements and failed to disclose internal control deficiencies); *Scottish Re*, 2007 WL 3256660, at *18 (sustaining Section 11 claims against auditors for failing to detect poor internal controls and the company's improper accounting of deferred tax assets); *Refco*, 503 F. Supp. 2d at 632-33 (sustaining Section 11 claims against auditor defendant); *Majesco*, 2006 U.S. Dist. LEXIS 73563, at *14-16 (sustaining Section 11 claims against auditor defendants because their "arguments as to the accounting practices employed are not ripe for adjudication at this early pleading stage"); *Holmes v. Baker*, 166 F. Supp. 2d 1362, 1369-72 (S.D. Fla. 2001) (holding that Section 11 claim against auditor sufficiently pled based on overstatements of income and overvalued inventory); *In re CBT*

Group PLC Sec. Litig., No. C-98-21014-RMW, 2000 WL 33339615, at *3-4 (N.D. Cal. Dec. 29, 2000) (upholding Section 11 claims against auditor on general allegations that financial statements unreasonably and materially overstated earnings and revenues in violation of accounting standards); *In re Transcrypt Int'l Sec. Litig.*, No. 4:98CV3099, 1999 U.S. Dist. LEXIS 17540, at *9-13 (D. Neb. Nov. 4, 1999) (noting that Section 11 claims are "based on principles of strict liability, negligence, and lack of due diligence, not fraud"); *In re First Merchs. Acceptance Corp. Sec. Litig.*, No. 97 C 2715, 1998 U.S. Dist. LEXIS 17760, at *34-37 (N.D. Ill. Nov. 2, 1998) (sustaining Section 11 claim against auditor where complaint sufficiently alleged violations of GAAP and GAAS).[55]

Indeed, as discussed above, Grant Thornton resorts to making inappropriate factual arguments and blaming RAIT's management while seeking to be dismissed from this "potentially massive securities fraud action" because they claim they were a "periphian player." GT. Mem. at 2.[56] Accordingly, Grant Thornton's argument that the Complaint fails to sufficiently allege that it made misstatements at the time of the July 2007 Preferred Stock Offering should be denied.

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[55] Grant Thornton incorrectly argues that Plaintiffs (without discovery) must, *inter alia*, identify the specific amount of the alleged accounting errors, what specific audit tests Grant Thornton could have conducted differently, and whether those tests would have prevented Grant Thornton from issuing an opinion. GT Mem. at 15-25. Those arguments are erroneous and should be rejected at this stage. *See, e.g.*, *Majesco*, 2006 U.S. Dist. LEXIS 73563, at *15.

[56] For example, Grant Thornton claims that accounting under SFAS 115 is a matter of "judgment" (GT Mem. at 14), that the SFAS 115 analysis requires "numerous factors to be considered (*id.* at 15 (internal quotation marks omitted)), and that the SFAS 115 analysis "will vary from case to case" (*id.* (internal quotation marks omitted)). *See also id.* at 16 ("[D]etermining the impairment of investments under FAS 115 requires the exercise of judgment, the use of estimates, and the prediction of future events.").

3. **Defendants' Standing Argument Is Premature** **<u>And An Improper Ground to Dismiss</u>**

Defendants argue that the Court should dismiss all claims against them arising from the July 2007 Preferred Stock Offering because Lead Plaintiff purportedly lacks standing to bring this claim on behalf of a class of investors. This argument is premature and not a proper basis for dismissal at the pleading stage.

Even if the Lead Plaintiff did not purchase any shares in or traceable to the July 2007 Preferred Stock Offering, there can be no dispute that <u>many other members of the Class did</u>. *See* Complaint, at 1 (defining the Class). Courts in this District have held that a Lead Plaintiff need not have personal standing to sue on every available cause of action. For instance, in *In re PMA Capital Corp. Sec. Litig.*, the Court, while acknowledging that the lead plaintiffs had not purchased the senior debentures at issue, declined to dismiss the Complaint, holding as follows:

> Nonetheless, the Court finds that Plaintiffs do have standing to pursue the §§ 11 and 12 claims for the Senior Debentures. Lead Plaintiffs may pursue claims on behalf of the entire class because they were appointed to oversee litigation on behalf of the class. The PSLRA does not require that the lead Plaintiffs have standing to sue on every available cause of action. *See Hevesi v. Citigroup, Inc.*, 366 F.3d 70, 82-83 (2d Cir. 2004) (refusing to adopt a per se rule that district courts must choose a lead plaintiff with standing to sue on every available cause of action because the PSLRA requires courts to choose a party who has the largest financial stake in the outcome of the case).

2005 WL 1806503, at *18 (E.D. Pa. July 27, 2005) (citation omitted); *see also Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc.*, No. 05 Civ. 1898, 2005 WL 2148919, at *7-8 (S.D.N.Y. Sept. 06, 2005) (holding that plaintiff had standing to sue on behalf of purchasers of different classes of securities since all class members "relied on the same repeated, material misstatements" concerning "underwriting practices" that were set forth in the various offering documents).[57]

Similarly, here, this Court appointed Lead Plaintiff to represent <u>the entire Class</u> of individuals and entities who purchased public securities of RAIT, which includes purchasers who were misled by Defendants' false statements into purchasing the preferred stock issued in the July 2007 Preferred Stock Offering. Thus, Defendants' standing argument should be rejected or, at a minimum, not addressed until class certification, when Lead Plaintiffs have had a chance to develop evidence that other members of the class purchased the preferred stock offered in the July 2007 Preferred Stock Offering (and perhaps proffer a named plaintiff at that time).

D. Defendants' Additional Arguments Provide No <u>Basis for Dismissing the Securities Act Claims</u>

Defendants make three additional arguments in seeking dismissal of certain of the Securities Act claims, arguing that (1) a highly-fact based affirmative defense of "due diligence" trumps the allegations of the Complaint at the pleading stage and permits the Trustee Defendants to be dismissed from the Complaint as a matter of law; (2) only the Underwriter Defendants, and not RAIT or its executives or Trustees, acted as "sellers" pursuant to Section 12(a)(2) of the Securities Act and therefore RAIT, the Officer Defendants and the Trustee Defendants (but not the Underwriter Defendants) must be dismissed from that claim; and (3) that the Class Period should be shortened now, as a matter of law, prior to the Court having the benefit of the parties' class certification motions. None of these arguments has merit.

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[57] In addition, several courts have held that standing questions cannot be resolved on a motion to dismiss. *See In re Suprema Specialties, Inc. Sec. Litig.*, 438 F.3d at 274-75 n.7; *Shapiro*, 964 F.2d at 286; *Gargulio v. Isolagen*, 527 F. Supp. 2d 384, 392 (E.D. Pa. 2007).

1. The Trustee Defendants' Affirmative "Due Diligence" Defense Is Not An Appropriate Ground For Dismissal On A Motion To Dismiss

While the Trustee Defendants primarily point the finger of blame for the fraud at RAIT, RAIT's senior executives and its auditor (Tr. Mem. at 4), they also ask the Court to address on this Rule 12(b)(6) motion their highly fact-intensive, affirmative defense of "reasonable reliance." *See* Tr. Mem. at 11-15. Their request should be rejected.

As the Trustee Defendants note, Section 11 of the Securities Act provides an affirmative defense to otherwise strict liability by allowing non-issuers to prove that they "had, after reasonable investigation, reasonable ground to believe and did believe," that a registration statement was neither false nor misleading, either affirmatively or by omission. *See* Tr. Mem. at 11 (citing 15 U.S.C. § 77k(b)(3)(A)). The full text of this provision states:

> (b) Persons exempt from liability upon proof of issues
>
> Notwithstanding the provisions of subsection (a) of this section no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof
>
> . . .
>
> (3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert, and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading . . . .

15 U.S.C. § 77k(b)(3)(A) (emphases added).

"This is an affirmative defense that must be pleaded and proved" by the Trustee Defendants, *Lone Star Ladies Inv. Club v. Schlotzsky's*, 238 F.3d 363, 369 (5th Cir. 2001), and therefore it is an inappropriate issue to resolve on a Rule 12(b)(6) motion. *See* 17 C.F.R. § 230.176 (listing numerous fact-specific considerations "affecting the determination of what constitutes reasonable investigation and reasonable grounds for belief under section 11 of the Securities Act"); *Herman & MacLean*, 459 U.S. at 382 ("[D]efendants bear the burden of demonstrating due diligence"); *In re Friedman's, Inc. Sec. Litig.*, 385 F. Supp. 2d 1345, 1369 (N.D. Ga. 2005) ("As determinations of the reasonableness of a defendant's reliance on expert opinion are fact-intensive inquiries, they are generally not properly resolved on motions to dismiss"); *In re Enron Corp.*, 258 F. Supp. 2d 576, 639 (S.D. Tex. 2003) ("Lead Plaintiff does not have the burden of pleading and proving Defendants' affirmative defenses of due diligence and/or reliance on an expert's opinion under § 11(b)(3), which expressly places the burden on Defendants. Nor is the fact-specific determination of 'the reasonableness' of a defendant's investigation or of his reliance on the opinion of an expert a question properly resolved on a motion to dismiss."); *cf. Grifffin v. PaineWebber, Inc.*, 84 F. Supp. 2d 508, 513 (S.D.N.Y. 2000) (holding that closely similar affirmative defense in Section 12 "is not a question properly resolved on a motion to dismiss.")

The Trustee Defendants attempt to overcome this by introducing documents outside the Complaint, namely, RAIT's Audit Committee Charter and Trust Governance Guidelines. *See* Tr. Mem. at 13-14. For at least three separate and distinct reasons, the Court should reject this argument. First, courts have rejected the specific kind of argument that the Trustee Defendants advance here. For example, in *In re Cendant Corp. Litig.*, the defendants argued for dismissal of Section 11(b)(3) claims based upon the findings of a document far more germane than the documents at issue here. Specifically, the defendants in that case based their affirmative defense on the findings of an independent investigatory report into the alleged fraud to which the complaint actually referred and that had been filed with the SEC. Still, the court denied the motion to dismiss, holding:

> The existence of the Report does not make it appropriate to consider the affirmative defense as a ground for dismissal at this stage of the litigation. Although the Report was filed with the SEC and referred to in the complaint, the Court may not consider the Report as proof of the facts asserted therein.

60 F. Supp. 2d 354, 365 (D.N.J. 1999).

In this case, the Trustee Defendants improperly urge the Court to accept as legally dispositive proof—before any discovery has occurred—two documents that are far less relevant than the independent investigatory report at issue in *In re Cendant Corp. Litigation*, and, moreover, are not referenced in the Complaint at all.

Second, the Complaint neither alleges the contents of those documents nor references them nor relies upon them in any way. Consequently, the Court should not consider them. *See Pryor v. NCAA*, 288 F.3d 548, 560 (3d Cir. 2002) (noting that such documents can be considered only when their "contents are alleged in the complaint" or if they are "referred to in the complaint and they are central to the claim" (cited in Tr. Mem. at 14)).[58]

Third, these extraneous documents, by themselves, do nothing to support the Trustee Defendants' "due diligence" affirmative defense because they do not show that the Trustee Defendants made any investigation, let alone the "reasonable" investigation that the statute requires. In short, the documents say nothing about what the Trustee Defendants in fact did or did not do to verify the information set forth in the relevant registration statements. Nor do these

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[58] The Trustee Defendants contend that their affirmative defense "appear[s] the face of the Complaint" because as "outside" trustees they were under a lesser duty to investigate and were supposedly "entitled to rely" on RAIT's management and auditor. Tr. Mem. at 14. This argument has a losing history. *See In re Friedman's, Inc. Sec. Litig.*, 385 F. Supp. 2d 1345, 1368 (N.G. Ga. 2005) ("Congress expressly required defendants to 'sustain the burden of proof' to establish the reasonableness of their actions . . . the Court cannot determine now, as a matter of law, that Defendants have established the statutory affirmative defense."). *See also id.* at 1369 n.26.

documents describe why the Trustee Defendants' reliance on RAIT's management after such an investigation is "reasonable."[59]

2. Defendants' Argument That Only The Underwriters Acted as "Sellers" Under Section 12(a)(2) Should be Rejected

The Officer Defendants contend that they should be dismissed from Counts II and V because only the Underwriter Defendants may be liable under those counts. Specifically, the Officer Defendants assert that it was the Underwriter Defendants—not RAIT—who sold the shares to the Lead Plaintiff and Class members. Therefore, the Underwriter Defendants, not they, are "sellers" within the meaning of Section 12(a)(2). The Officer Defendants also assert that the Complaint fails to sufficiently allege that it solicited the Lead Plaintiff's and Class Members' purchases to establish it as a seller under section 12(a)(2). While the Officer Defendants are correct that the title to the shares passed from the Underwriter Defendants to the Plaintiffs, their argument that Plaintiffs have failed to establish that RAIT was a "solicitor seller" under Section 12(a)(2) is without merit.

The Complaint alleges the very types of allegations that courts have consistently held establish that an issuer and its officers were "solicitor sellers" under Section 12(a)(2) by showing that RAIT's actions went beyond just passively sitting back and letting the Underwriter

[59] The Trustee Defendants argue—but no other Defendants do—that this case should be dismissed because it is a "disguised" derivative claim that seeks to redress harm done to RAIT by RAIT's management. Tr. Mem. at 9-11. They are wrong. The Complaint expressly pleads violations of the federal securities laws and alleges numerous material misrepresentations and omissions that were made in order to artificially inflate the price of RAIT's securities. Lead Plaintiff alleges harm to itself and other members of the Class (all securities holders of RAIT) and names RAIT as a Defendant. *See, e.g., Hayes v. Gross*, 982 F.2d 104, 108 (3d Cir. 1992) (holding that because plaintiffs' claims "allege[] direct injury to [plaintiffs] and state[] a claim under the securities laws, we will reverse the [district court's holding that the claim was derivative in nature along with its] dismissal [of the claim] and remand").

Defendants take sole responsibility for the successful solicitation of the purchases.[60] Plaintiffs have alleged RAIT's (i) involvement in the preparation of the false January 2007 and July 2007 Registration Statements and prospectuses via the Officer Defendants' signatures (¶¶20-23, 113, 124); (ii) financial motivation for soliciting the Lead Plaintiff and Class Members to purchase its common and preferred stock (¶¶112, 114, 123);[61] (iii) communications with analysts and investors (¶¶68-71, 85, 248-50, 256-57, 272-75, 296-98);[62] and (iv) successful solicitation of the Lead Plaintiff's and Class Members' purchases of RAIT's securities in the January 2007 Stock Offering and July 2007 Preferred Stock Offering. ¶¶182, 218

Courts routinely hold that to establish that an issuer was a "solicitor seller" at the pleading stage, a plaintiff need only plead facts showing that the issuer was involved in preparing the false and misleading registration statement and had at least some partial financial motive in the sale of its securities to the ultimate purchasers. *See, e.g.*, *In re NationsMart Corp. Sec. Litig.*, 130 F.3d 309, 319 (8th Cir. 1997) (holding that the issuer in a firm commitment IPO was a "seller" under Section 12(a)(2) where plaintiffs alleged that it had "solicited sales of shares, by means of the Prospectus" even though plaintiffs had failed to "allege[] specific facts demonstrating that the [issuer] actively solicited the sale of the shares to the plaintiffs"); *In re*

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[60] Officer Defendants' citation to *Lone Star Ladies Inv. Club v. Schlotzsky's, Inc.*, 238 F.3d 363, 370 (5th Cir. 2001) is of no help because the plaintiffs in that case did not allege any facts showing that the issuer solicited the purchasers of its securities. Further, the appellate court actually reversed the district court's denial of leave to amend, reasoning that "this claim cannot be decided in this case and on these facts upon a Rule 12(b)(6) motion, although the parties may bring the question again [in a motion for summary judgment]."

[61] *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, (1st Cir. 1996), which Officer Defendants cite in support of their argument, is distinguishable in that the plaintiffs in that case failed to allege any financial motive on the part of the issuer for soliciting the purchases, which, as noted above, Lead Plaintiff has done here.

[62] Officer Defendants citation to *Rosenzweig v. Azurix Corp.*, 332 F.3d 854, 871 (5th Cir. 2003), is of no support because the plaintiffs in that case failed to allege any direct communication with the purchasers of the securities.

Westinghouse Sec. Litig., 90 F.3d 696, 717 (3d Cir. 1996) (reversing district court's dismissal of Section 12(a)(2) claim against issuer defendants where complaint alleged that the issuer "solicited plaintiffs" to purchase securities "and that in doing so [] were motivated by a desire to serve their own financial interests"); *In re Scottish RE Group Sec. Litig.*, 524 F. Supp. 2d 370, 400 (S.D.N.Y. 2007) (holding that allegations that "Company conducted a public offering of its securities through the Underwriter Defendants and impl[ied] that the Company benefited financially from the sale of these securities [] are sufficient to state a claim that the Company was a statutory seller under section 12.")

Further, courts have held that the signing of a registration statement is "in itself [] particularly significant for the purposes of finding that a [person] is a seller," *In re Vivendi Universal, S.A. Sec. Litig.*, 381 F. Supp. 2d 158, 187 (S.D.N.Y. 2003) (internal citation omitted and alteration in original), and "is at this stage of the proceedings, a sufficient allegation to permit Plaintiffs [to withstand a motion to dismiss]," *Degulis v. LXR Biotechnology, Inc.*, 928 F. Supp. 1301, 1315 (S.D.N.Y. 1996). *See also Lone Star Ladies Inv. Club v. Schlotzsky's, Inc.*, 238 F.3d 363, 370 (5th Cir. 2001) (holding that whether an issuer is a solicitor seller for the purpose of section 12(a)(2) cannot be decided "upon a Rule 12(b)(6) motion," and instead must be addressed "upon a properly developed record under Rule 56"). Courts have also held that an issuer's communications with analysts and investors support the conclusion that an issuer is a "solicitor seller" under Section 12(a)(2). *See, e.g., In re Royal Ahold N.V. Sec. & ERISA Litig.*, 384 F. Supp. 2d 838, 842 (D. Md. 2005) (holding that an issuer defendant's participation in conference calls was evidence of solicitation); *In re Vivendi Universal, S.A. Sec. Litig.*, 381 F. Supp. 2d 158, 186 (S.D.N.Y. 2003) (holding that officer defendant's participation in discussions with news agencies and investors, along with his signing of registration statements and alleged financial motives, established him as a solicitor seller under Section 12(a)(2)).[63]

E. <u>The Complaint's Control Person Allegations Should Be Sustained</u>

RAIT's Officers seek dismissal of all of the control person claims asserted against them under Section 15 of the Securities Act on the sole ground that the Complaint has not adequately alleged a primary violation of Sections 11 or 12(a)(2). Because these primary claims have been sufficiently alleged, these control person liability claims should be sustained as well. *Middlesex Ret. Sys. v. Quest Software Inc.*, CV 06-6863, 2007 U.S. Dist. LEXIS 84695, at *76-77 (C.D. Cal. Oct. 22, 2007).

III. THE COURT SHOULD NOT ADJUST THE CLASS PERIOD ON A MOTION TO DISMISS

In the final two sentences of their brief—and without any case citation whatsoever—the Section 10(b) Defendants ask the Court to determine now, as a matter of law in advance of discovery, that the Class Period should be shortened. Specifically, the Section 10(b) Defendants ask the Court to begin the Class Period on December 11, 2006, when RAIT completed its acquisition of Taberna, rather than on June 8, 2006, when RAIT and Taberna first announced the merger. The Court should deny this cursory, unsupported request for at least three separate and distinct reasons.

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[63] Though it is cited by the Officer Defendants, *In re Craftmatic Sec. Litig.*, 890 F.2d 628, 637 (3d Cir. 1990), actually supports the Lead Plaintiff on this point. In *In re Craftmatic Sec. Litig.*, the Third Circuit reversed a district court's dismissal of plaintiffs' Section 12(a)(2) claim against the issuer whose shares were sold to plaintiffs through an underwriter in a firm commitment offering. In that complaint, plaintiffs alleged that the issuer "solicited plaintiffs . . . to buy [the issuer's] common stock . . . and in so acting [was] motivated by a desire to serve [its] own financial interests [and was involved] with the preparation of the false and misleading Prospectus and Registration Statement used in conjunction with the sale of the securities." *Id.* Most importantly, the court added that at the motion to dismiss stage it "cannot be said at this juncture that plaintiffs can prove no set of facts that would entitle them to relief." *Id.*

First, the Section 10(b) Defendants ignore (or misunderstand the import of) the fact that they have conceded the falsity of certain statements made before December 11, 2006.[64] Without explaining why, the Section 10(b) Defendants appear to contend that the Class Period cannot start when these Defendants made their first (undisputed) false statement on June 8, 2006, and must instead wait until Taberna's assets were officially transferred to RAIT. But pursuant to Rule 10(b)(5), the Class's claims arise—and thus the Class Period begins—with the Defendants' first false statement or omission, regardless of when Taberna's assets were transferred. *See* 17 C.F.R. § 240.10b-5 (making "unlawful . . . any untrue statement of material fact" or omission of any "material fact necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading"); *see generally In re Gilat Satellite Networks, Ltd.*, No. Civ. 02-1510, 2007 WL 2743675, at *6 (E.D.N.Y. Sept. 18, 2007) (approving class action settlement and noting that "the relevant Class Period begins on February 10, the first trading day after the allegedly false statements").

Second, it is common for a class consisting of the shareholders of an acquiring company to commence its class period on or even before the date of merger announcement, rather than on the date the merger became effective. *See generally Weiner v. Quaker Oats Co.*, 129 F.3d 310, 313-14 (3d Cir. 1997) (holding that class of Quaker Oats shareholders stated claim based upon false statements issued before acquisition of Snapple); *Antonson v. Robertson*, 141 F.R.D. 501, 504 (D. Kan. 1991) (certifying class of ACI investors and a class period beginning with ACI's announcement of a definitive agreement for the acquisition of another company). Accordingly, beginning the Class Period with the merger announcement is routine and uncontroversial.

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[64] As noted above, the Section 10(b) Defendants do not dispute the falsity of a series of statements they made in conference calls and in an accompanying slide presentation on June 9, 2006. ¶¶68-71. Nor do the Section 10(b) Defendants challenge the falsity or materiality of other statements before December 11, 2006, such as Betsy Cohen's November 3, 2006 statement. ¶85.

Third, determining the precise length of a class period is a fact-intensive endeavor. The inherently factual nature of this inquiry has led numerous courts to decline to adjust the class period even on a motion for class certification, which is based on a much more substantial record. *See In re Scientific-Atlanta, Inc. Sec. Litig.*, No. 1:01-CV-1950-RWS, 2007 WL 2683729, at *21-22 (N.D. Ga. Sept. 7, 2007) (declining to shorten the class period on a motion for class certification because "[o]n the record before it, the Court concludes there is a substantial question of fact"); *In re Interpublic Sec. Litig.*, No. 02-Civ.-6527, 2003 WL 22509414, at *5 (S.D.N.Y. Nov. 6, 2003) (refusing to shorten the class period on a motion for class certification in light of "questions of fact"); *In re AMF Bowling Sec. Litig.*, No. 99 Civ. 3023, 2002 WL 1033826 (S.D.N.Y. May 21, 2002); *Weiner v. Quaker Oats Co.*, No. 98 C. 3123, 1999 WL 1011381, at *11 (N.D. Ill. Sept. 30, 1999); *First Eastern Corp. v. Mainwaring*, No. 92-Civ.-1176, 1993 WL 223607, at *3 (E.D. Pa. June 22, 1993). Such an unwarranted adjustment of the Class Period should certainly not be made now, as a matter of law—before any discovery has taken place.

CONCLUSION

For the foregoing reasons, all moving Defendants' motions to dismiss the Complaint should be denied in their entirety.[65]

Dated: May 15, 2008

BERNSTEIN LITOWITZ BERGER & GROSSMANN LLP

By: /s/ Chad Johnson
By: /s/ John Rizio-Hamilton

Chad Johnson
Chad@blbglaw.com
Gerald H. Silk
John C. Browne
John Rizio-Hamilton
Johnr@blbglaw.com
1285 Avenue of the Americas
New York, New York 10019
Tel: (212) 554-1400
Fax: (212) 554-1444

Attorneys for Lead Plaintiff Brahman Capital Corp. and Court-appointed Lead Counsel for the Class

FINE, KAPLAN AND BLACK, R.P.C.
Roberta D. Liebenberg (PA ID # 31738)
rliebenberg@finekaplan.com
Ria C. Momblanco (PA ID # 201818)
rmomblanco@finekaplan.com
1835 Market Street, 28th Floor
Philadelphia, Pennsylvania 19103
Tel: (215) 567-6565
Fax: (215) 568-5872

Liaison Counsel for Lead Plaintiff Brahman Capital Corp. and the Class

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[65] As is customary, if the Court dismisses any of Lead Plaintiff's claims (and it should not), Lead Plaintiff should have the opportunity to replead.

BERNSTEIN LIEBHARD
& LIFSHITZ, LLP
Sandy A. Liebhard
Joseph R. Seidman, Jr.
10 East 40th Street
New York, NY 10016
Tel: (212) 779-1414
Fax: (212) 779-3218

Attorneys for Additional Named Plaintiff
Employees' Retirement System of the
State of Rhode Island