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**UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY**

MICHAEL V. MALLOZZI, Individually
and on behalf of all others similarly
situated,

Plaintiff,

v.

INNOVATIVE INDUSTRIAL
PROPERTIES, INC., PAUL SMITHERS,
CATHERINE HASTINGS, ALAN GOLD,
and BENJAMIN C. REGIN,

Defendants.

Case No. 2:22-cv-02359-EP-JRA

**PLAINTIFFS' MEMORANDUM
OF LAW IN OPPOSITION TO
DEFENDANTS' MOTION TO
DISMISS THE AMENDED CLASS
ACTION COMPLAINT FOR
VIOLATIONS OF THE FEDERAL
SECURITIES LAWS**

JURY TRIAL REQUESTED

TABLE OF CONTENTS

I. PRELIMINARY STATEMENT 1

II. STATEMENT OF FACTS 2

III. ARGUMENT..... 10

 A. The Complaint Adequately Pleads Falsity 11

 1. The Risk Warnings Discussing Due Diligence are Adequately Pleaded as False 12

 2. Defendants’ Statements Discussing IIPR’s Investment in Kings Garden are Adequately Pleaded as False..... 16

 3. Defendants’ Statements Praising Kings Garden are Adequately Pleaded as False 17

 a) August 7, 2020-April 13, 2022 17

 b) April 14, 2022-August 4, 2022 19

 4. The Complaint Adequately Pleads GAAP Violations 20

 B. The Complaint Adequately Pleads Scierter..... 21

 1. The Complaint Adequately Pleads Serial, Severely Reckless Conduct 23

 2. GAAP Allegations Support a Strong Inference of Recklessness 32

 3. Motive Allegations Support Strong Inference of Scierter 34

 4. The Complaint Adequately Pleads the Scierter of All Defendants 36

IV. CONCLUSION..... 41

TABLE OF AUTHORITIES

	Page(s)
Cases	
<i>Allegheny Cnty. Employees' Ret. Sys. v. Energy Transfer LP</i> , 532 F. Supp. 3d 189 (E.D. Pa. 2021).....	37
<i>Ashcroft v. Iqbal</i> , 556 U.S. 662 (2009)	10
<i>Bell Atl. Corp. v. Twombly</i> , 550 U.S. 544 (2007)	10
<i>Berson v. Applied Signal Tech., Inc.</i> , 527 F.3d 982 (9th Cir. 2008).....	15
<i>Bishins v. Cleanspark, Inc.</i> , 2023 WL 112558 (S.D.N.Y. Jan. 5, 2023).....	25, 30
<i>Blank v. TriPoint Glob. Equities, LLC</i> , 338 F. Supp. 3d 194 (S.D.N.Y. 2018).....	24, 25
<i>Christian v. BT Grp. Plc</i> , 2020 WL 1969941 (D.N.J. Apr. 24, 2020).....	32
<i>De Vito v. Liquid Holdings Group, Inc.</i> , 2018 WL 6891832 (D.N.J. Dec. 31, 2018)	18
<i>Dow Corning Corp. v. BB&T Corp.</i> , 2010 WL 4860354(D.N.J. Nov. 23, 2010).....	34
<i>Dura Pharms., Inc. v. Broudo</i> , 544 U.S. 336 (2005)	11
<i>Global Network Comm., Inc. v. City of New York</i> , 458 F.3d 150 (2d Cir. 2006).....	10
<i>GSC Partners CDO Fund v. Washington</i> , 368 F.3d 228 (3d Cir. 2004).....	26

In re Adolor Corp. Sec. Litig.,
616 F. Supp. 2d 551 (E.D. Pa. 2009).....35

In re Alstom SA,
454 F. Supp. 2d 187 (S.D.N.Y. 2006).....31

In re Aphira, Inc. Sec. Litig.,
2020 WL 5819548 (S.D.N.Y. Sept. 30, 2020)26

In re Cognizant Tech. Solutions Corp. Sec. Litig.,
2020 WL 3026564 (D.N.J. June 5, 2020)39

In re Doral Fin. Corp. Sec. Litig.,
563 F. Supp. 2d 461 (S.D.N.Y. 2008).....31

In re Intelligroup Sec. Litig.,
527 F. Supp. 2d 262 (D.N.J. 2007)..... 23, 33

In re Navient Corp. Sec. Litig.,
2019 WL 7288881 (D.N.J. Dec. 30, 2019)32

In re Novo Nordisk Sec. Litig.,
2018 WL 3913912 (D.N.J. Aug. 16, 2018).....36

In re Stable Road Acquisition Corp.,
2022 WL 2762213 (C.D. Cal. July 13, 2022) 25, 38

In re Suprema Specialties, Inc. Sec. Litig.,
438 F.3d 256 (3d Cir. 2006).....27

Indiana Pub. Ret. Sys. v. SAIC, Inc.,
818 F.3d 85 (2d Cir. 2016)35

Indiana Public Ret. Sys. v. AAC Hldgs, Inc.,
2021 WL 1316705 (M.D. Tenn. Apr. 8, 2021)30

Institutional Invs. Grp. v. Avaya, Inc.,
564 F.3d 242 (3d Cir. 2009)..... 22, 23, 34

Kline v. First W. Gov't Sec., Inc.,
24 F.3d 480 (3d Cir. 1994)16

Novak v. Kasaks,
216 F.3d 300 (2d Cir. 2000) 24, 26, 31

Oran v. Stafford,
226 F.3d 275 (3d Cir. 2000)36

Oregon Laborers Employes Pension Trust Fund v. Maxar Tech., Inc.,
2020 WL 5500458 (D. Colo. Sept. 11, 2020)33

Roofer’s Pension Fund v. Papa,
2018 WL 3601229 (D.N.J. July 27, 2018)33

Rothman v. Gregor,
220 F.3d 81 (2d Cir. 2000)33

S.E.C. v. Egan,
994 F. Supp. 2d 558 (S.D.N.Y. 2014)21

Schueneman v. Arena Pharms., Inc.,
840 F.3d 698 (9th Cir. 2016)28

Setzer v. Omega Healthcare Invs., Inc.,
968 F.3d 204 (2d Cir. 2020)12

Sheet Metal Workers Nat. Pens. Fund v. Bayer,
AG, 2021 WL 4864421 (N.D. Cal. Oct. 19, 2021)..... 14, 15

Sjunde AP-Fonden v. Goldman Sachs Grp., Inc.,
545 F. Supp. 3d 120 (S.D.N.Y. 2021) 28, 31

SLF Hldgs, LLC v. Uniti Fiber Hldgs, Inc.,
499 F. Supp. 3d 49 (D. Del. 2020)32

Strougo v. Mallinckrodt,
Plc, 2022 WL 17740482 (D.N.J. Dec. 16, 2022)..... 24, 38

Sun v. Han,
2015 WL 9304542 (D.N.J. Dec. 21, 2015)27

Tellabs, Inc. v. Makor Issues & Rts., Ltd.,
551 U.S. 308 (2007) 10, 22, 23

Virginia Bankshares, Inc. v. Sandberg,
501 U.S. 1083 (1991)18

Williams v. Globus Med., Inc.,
869 F.3d 235 (3d Cir. 2017)..... 13, 16

Rules

Fed. R. Civ. P. 12(b)(6)..... 10, 11

Lead Plaintiff Alejandro Handal, and Named Plaintiff Stephen R. Forrester (“Plaintiffs”), respectfully submit this memorandum of law in opposition to Defendants’ Innovative Industrial Properties, Inc. (“IIPR”), Paul Smithers (“Smithers”), Catherine Hastings (“Hastings”), Alan Gold (“Gold”), and Benjamin C. Regin (“Regin”) (collectively, “Defendants”) Motion to Dismiss (Dkt. No. 42),¹ and states the following:

I. PRELIMINARY STATEMENT

Well before IIPR ever transacted with Kings Garden and Michael King, easily accessible evidence existed that Kings Garden was a Ponzi scheme and Michael King a fraudster. Performing essentially no due diligence on King or Kings Garden, IIPR purchased 6 properties from Kings Garden for tens of millions of dollars. Defendants’ repeated failures to perform due diligence and repeated praising of Kings Garden renders all of their statements about Kings Garden and their accounting for Kings Garden actionably false.

This Court must decide whether Defendants’ conduct before and during the Class Period amounts to an extreme departure from the standards of ordinary care so obvious that it presents a risk of misleading investors, or whether Defendants were monumentally incompetent, Defendants’ only competing inference.

¹ Plaintiffs cite to the Complaint (Dkt. No. 34) as “¶__” and to the Exhibits as “Ex. __.” Plaintiffs cite to Defendants’ Memorandum of Law (Dkt. No. 42) as “DMem __” and Defendants Exhibits to the DeGennaro Decl. (Dkt. No. 43) as “DEx __.”

Defendants did not perform the background checks they said they did, relying instead of Kings Garden's principals. They ignored red flags of "highly unusual" conduct, they ignored suspicious Kings Garden's financial statements they possessed, they did not monitor Kings Garden's credit quality, and they made no effort to verify Draw Requests.

On April 14, 2022, IIPR received actual knowledge that Kings Garden was likely a fraud. In response, they claimed that they had verified all Draw Requests, a lie. Three weeks later, they doubled down, praising Kings Garden profusely. Given these particularized facts, Defendants either knew that Kings Garden was a Ponzi scheme, or their failure to discover it is a profoundly extreme departure from the standards of ordinary care. For the following reasons, therefore, this Court should deny the motion to dismiss in its entirety.

II. STATEMENT OF FACTS

Founded in 2016, IIPR is an internally-managed real estate investment trust ("REIT") focused on the acquisition, ownership, and management of properties leased to state-licensed operators for their regulated cannabis facilities. ¶29. IIPR acquires its properties through sale-leaseback transactions. The tenant is responsible for all aspects of and costs and operation of the property. ¶30. Because marijuana cultivators do not have access to the banking system, IIPR bought land from growers at rates far higher than paid by the grower, with the excess sale price extended back

to the operator as loans at high interests rates.¶32. IIPR told investors finding a replacement operator would be extremely difficult and involve lower rents. ¶33. As of December 31, 2020, IIPR had 15 full-time employees.² As of December 31, 2021, IIPR had 18 full-time employees.³

Throughout the Class Period⁴ IIPR emphasized the necessity of the due diligence it stated that it undertook before and after entering into transactions with operators, and the risks of not performing that due diligence. IIPR stated that “[w]e rely on our management team to perform due diligence investigations of our potential tenants, related guarantors and their properties, operations and prospects.” ¶120.⁵ In the Q2 2020 10-Q, IIPR assured that “we monitor our tenants by periodically conducting site visits and meeting with the tenants to discuss their operations....” ¶121. In an August 5, 2021, earnings conference call, Defendant Gold assured that IIPR “focus[es] ... not only on the real estate, but that it “spen[ds] a lot of time with the management team, evaluating their skills and expertise ... [a]nd we utilize our existing network of growers to do background checks on these tenants,

² See DEX A at 7.

³ See DEX B, at p. 6/182.

⁴ The Class Period runs from August 7, 2020-August 4, 2022. ¶1.

⁵ IIPR admits that the “management team” was led by Defendant Gold. See DEX B at 9/182.

understanding where they've come from and their reputations in the specific state or just in the industry in general.” ¶47.

In April 2019 IIPR entered into a sales-leaseback transaction with marijuana cultivator Kings Garden, led by its CEO and Chairman Michael King (“King”). ¶34. Between 2019-2021, IIPR purchased 6 California properties from Kings Garden, at prices far higher than Kings Garden had paid for the properties. ¶¶36, 168. In total, IIPR invested approximately \$150 million into Kings Garden cannabis farms. ¶42. Kings Garden was one of IIPR’s largest operators, accounting for up to 10% of IIPR’s rental revenues. ¶¶37, 122.

Two of those projects, the San Bernardino and 19th Street properties, had allowances for up to a total of \$76.4 million in “Draw Requests,” to reimburse for approved construction projects.” ¶¶53-54. Draw Requests were sent to IIPR’s “Construction Team,” which reported to Defendant Hastings, who had to approve all disbursements. ¶51. IIPR stated that the Construction Team checked any Draw Request “for accuracy and compliance with acceptable construction parameters.” ¶51; *see also* Ex. 3 at 6.⁶ Under the lease terms, each Draw Request was to be “executed by the general contractor and by the architect, and any subcontractors ... [and] attach invoices from the general contractor, the architect, and any

⁶ Ex. 3 is IIPR’s Amended Complaint in its lawsuit alleging fraud by Kings Garden and King specifically.

subcontractors” Ex. 3 at 6. At the end of the Class Period, IIPR stated that it had paid \$49 million dollars in Draw Requests to Kings Garden for work that had never been performed, due to forged Draw Requests and invoices. ¶46 at n.5.

Red flags about King and Kings Garden existed even before IIPR ever transacted with Kings Garden. On January 29, 2019, Swiss American Investment Corporation, one of Kings Garden’s investors, filed suit alleging that Kings Garden had not paid Swiss American the quarterly dividends due it under the terms of its investment with Kings Garden, that there had been “irregular” transactions involving millions of dollars between Kings Garden and its managing directors, multiple related-party transactions between Kings Garden and entities its managing members owned or controlled, and that there was “self-dealing ... and a lack of transparency around its financial affairs.” ¶¶66-67 & n.9.⁷ IIPR could have discovered this lawsuit with a simple search, or by asking King if there was any outstanding or old litigation.

IIPR’s due diligence check was essentially non-existent. It relied heavily on Kings Garden’s license to grow cannabis in California, even as IIPR knew that King did not have any such license. ¶34; Ex. 3 at 5. King personally represented to IIPR that he had been “screened and cleared at all levels” by the Department of Justice

⁷ The Swiss American Complaint, which is incorporated by reference, is attached as Exhibit A to the Declaration of Gonen Haklay (“Haklay Decl.”).

for federal licensing, and cleared by the State of California. ¶34; Ex. 3 at 5. IIPR never checked whether these claims was true, instead accepting King’s word for it. ¶34. In addition, IIPR relied on the nice things Kings Garden wrote about itself on its website. Ex. 3 at 4. Starting in November 2019, Kings Garden supplied IIPR with quarterly financial statements. ¶59. IIPR would later claim that the financial records showed fraud by Kings Garden.

More red flags arose concerning Kings Garden throughout the Class Period. During the August 6, 2020 earnings conference call, Defendant Regin announced that in June of 2020 Kings Garden had distributed a quarterly dividend to its own equity investors, a decision that Regin called “highly unique,” ¶122, and during a February 25, 2021 earnings called “a remarkable achievement.” ¶139. During the February 24, 2022 earnings call to discuss fiscal year 2021, Defendant Regin returned to the same topic, stating that Kings Garden did so because it was a “uniquely positioned operator.” ¶48. Any such unique action was a red flag, especially in light of the accessible Swiss American lawsuit alleging fraudulent disbursements of Kings Garden funds to King and other Kings Garden leaders.

In May of 2021 Paul King, King’s brother, sued King and Kings Garden, alleging that King falsified books and records to enrich himself, swindled money from investors, used Kings Garden funds for his personal benefit, and committed fraud with respect to its financial, regulatory, and tax reporting. ¶¶68-69.

The Draw Requests submitted by Kings Garden to IIPR were another red flag. In mid-2021, Kings Garden submitted its first Draw Request for almost \$1.5 million. ¶58. A year later, in its lawsuit against Kings Garden, IIPR stated that the Draw Request was an obvious forgery just by looking at it, with inconsistent font and text boxes and metadata that showed the underlying document had been created in 2017. ¶58. IIPR reprinted part of this Draw Request in its lawsuit against Kings Garden, with the document so obviously forged that no arrows or highlighting were inserted to point out the font and other inconsistencies. Ex. 3 at 11.

Between July 2021 and June 2022, Kings Garden submitted Draw Requests totaling \$48.5 million for the San Bernardino and 19th Street projects,. Ex. 3 at 7-9; ¶54. Even as forged Draw Requests were repeatedly submitted by Kings Garden, Defendants stated its Construction Team “regularly requested, and received, construction updates and/or site visits directly from [Kings Garden][.]” ¶55. IIPR paid Draw Requests that were missing required signatures. IIPR reprinted one of the earliest Draw Requests it received from Kings Garden in its lawsuit against Kings Garden, and the Draw Request is plainly missing an architect’s signature. Ex. 3 at 6.

On April 14, 2022, before the market opened, Blue Orca released a short seller report (“Blue Orca report”). ¶64. The Blue Orca report discussed negative information about King and Kings Garden, including the January 2019 Swiss American lawsuit with its claims of financial improprieties in the millions of dollars.

¶¶66-67. The Blue Orca report discussed Paul King’s 2021 lawsuit against his brother King and Kings Garden, also alleging massive misappropriation of funds from Kings Garden to King, and financial, regulatory, and tax reporting fraud. ¶¶68-69. The Blue Orca report further described multiple occasions where IIPR overvalued the fair value of its land purchases in its financial statements, creating a false impression of IIPR’s financial health for investors. ¶¶70-78, 174.

On this disclosure IIPR’s stock fell by 7.5%, from \$183.44 at the close of trading on April 13, 2022, to close at \$169.68 on April 14, 2022, damaging investors.

The same day, April 14, 2022, IIPR issued a press release dismissing and denying every aspect of the Blue Orca report. Ignoring the lawsuits, IIPR stated that Blue Orca had a “lack of understanding” and “failed to have any comprehension” of commercial real estate generally, or of the cannabis industry. ¶176. IIPR assured that it only reimbursed operators for improvements to property that it had “verified.” ¶176. Summarily dismissing the Blue Orca report, IIPR stated that its “flawed nature and disinformation ... does not warrant a response from IIP.” ¶176.

On May 5, 2022, during the Q1 2022 earnings conference call, IIPR doubled down, with Defendant Gold stating that “Michael King and his team have one of the best reputations for product quality and consistency and perhaps the single largest cannabis market in the world.” ¶184. Further, Defendant Regin again extolled Kings Garden for issuing a “highly unusual” quarterly dividend since May of 2020, never

mentioned the Blue Orca report or other red flags showing that King misappropriated funds from Kings Garden. ¶49.

On June 1, 2022, Kings Garden submitted its sixth Draw Request for the 19th Street property. ¶57. IIPR called Kings Garden, which admitted that it had been forging Draw Requests, rather than having contractors and architects prepare them. ¶57. Reviewing all of the Draw Requests, IIPR saw that the initial Draw Request was an obvious forgery. ¶58. IIPR then reviewed the Kings Garden financial records it had been receiving quarterly, discovering tens of millions of dollars disappearing from Kings Garden's accounts through suspicious loans. ¶59. IIPR called the contractors whose signatures were on the Draw Requests and discovered that they had performed very little of the work for which IIPR reimbursed Kings Garden, and IIPR visited the sites and saw that work that had been the subject of paid Draw Requests had not been performed. ¶¶60-61.

On July 14, 2022, after the market closed, IIPR filed a Form 8-K stating that Kings Garden had defaulted on its July rent obligations for all 6 properties. ¶186. On this news, IIPR's stock price fell by 14.3%, from a close of \$111.61 on July 14, 2022, to a July 15, 2022 closing price of \$95.70, damaging investors. ¶188.

On August 4, 2022, after the market closed, IIPR filed its Q2 2022 10-Q. IIPR announced that it had filed suit against King and Kings Garden on July 25, 2022, for, among other claims, fraud and RICO violations. ¶189. On this news, IIPR's

stock price fell by 4%, from a close of \$98.40 on August 4, 2022, to an August 5, 2022 closing price of \$94.41, damaging investors.

In an August 16, 2022 filing in its lawsuit against Kings Garden, Ex. 4, requesting that the Court appoint a receiver for Kings Garden, IIPR called Kings Garden a “Madoff-style Ponzi scheme.” ¶63; Ex. 4 at 1. IIPR stated that it had belatedly discovered King’s history of over 32 lawsuits, felony charges, and fraudulent misconduct, concluded from Kings Garden’s financial statements that \$15 million dollars had disappeared from Kings Garden’s accounts, and saw suspicious loans from Kings Garden’s coffers to individuals that “may have connections to organized crime.” ¶59; AC Exhibit 4 at 3.

III. ARGUMENT

On a motion to dismiss under Fed. R. Civ. P. 12(b)(6), the Court accepts all allegations in the Complaint as true, construing them in the light most favorable to and drawing all reasonable inferences in Plaintiff’s favor. *Tellabs, Inc. v. Makor Issues & Rts., Ltd.*, 551 U.S. 308, 322 (2007). The Complaint’s allegations suffice if they state “a claim to relief that is plausible on its face.” *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (citing *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). The Court may consider documents extraneous to the Complaint, but only to determine what was said, and not for the truth of the matter. *Global Network Comm., Inc. v. City of New York*, 458 F.3d 150, 157 (2d Cir. 2006). While the Exchange Act

heightens the scienter pleading requirements, the statute does not alter the usual contours of a Fed. R. Civ. P. 12(b)(6) ruling for any other element of a Rule 10b-5 claim. *See Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 346 (2005).⁸

A. The Complaint Adequately Pleads Falsity

The Complaint adequately pleads falsity. Defendants admit to all the facts establishing falsity. Defendants themselves stated that Kings Garden was a Ponzi scheme, and that it was one even before it ever contracted with IIPR. ¶¶59, 63. Defendants admit they invested \$150 million in a Ponzi scheme, ¶42, and the Complaint’s allegations concerning Defendants’ statements about due diligence, and about King and Kings Garden, are actionably false. Bereft of cogent arguments undermining the strong falsity allegations, Defendants fling mud all around, hoping to distract. They argue about forward-looking statements, when the Complaint does not allege any such statements are false.⁹ They reprint portions of multiple risk warnings, which do not bear on the specific risk warnings alleged as false.¹⁰ They

⁸ Defendants challenge only the elements of falsity and scienter.

⁹ *See* DMem 19-21. None of the 14 paragraphs beginning with “the foregoing was false and misleading because” discusses projections or forecasts, nor does the Complaint even mention the “safe harbor.”

¹⁰ *See* DMem 6-8, 15-16. The Complaint delineates specifically which risk warnings were materially false, why they were false, and the specific information Defendants were duty-bound but failed to disclose.

list, for no reason whatsoever, unrelated suits that were dismissed against cannabis companies.¹¹

1. The Risk Warnings Discussing Due Diligence are Adequately Pleaded as False

Defendants argue that their due diligence risk warnings are not false, and that risk warnings issued before the first Draw Request in 2021 cannot be actionable because “it could not have possibly disclose Kings Garden’s fraudulent conduct because it had not yet occurred.” DMem 17. Defendants are wrong. The risks warned about had already materialized by the start of the Class Period—Kings Garden and King were frauds running a Ponzi scheme, and IIPR was dumping millions of dollars into that Ponzi scheme—so whether the risk warnings were issued before or after the first Draw Request, fraud was already occurring. Having spoken about due diligence in the context of risk warnings, Defendants were duty-bound to disclose that Kings Garden was a fraud, but did not.¹² “A company may be liable under

¹¹ See DMem 2 n.1. Defendants’ list of cases is probative of nothing, just as a list of cases involving REITs that advanced beyond the motion to dismiss stage would be irrelevant to a consideration of the pleadings in this case. See, e.g., *Setzer v. Omega Healthcare Invs., Inc.*, 968 F.3d 204 (2d Cir. 2020) (reversing dismissal of securities case against healthcare REIT).

¹² The Complaint’s allegations rendered false by this failure are ¶¶120-121 (Q2 2020 risk warnings); ¶¶126-127 (Q3 2020 risk warnings); ¶¶132-135 (FY 2020 disclosures); ¶¶143-145 (Q1 2021 risk warnings); ¶¶149-150 (Q2 2021 risk warnings); ¶¶158-159 (Q3 2021 risk warnings); ¶¶164-165, 168 (FY 2021 risk warnings); ¶¶178-179 (Q1 2022 Risk warnings).

Section 10(b) for misleading investors when it describes as hypothetical a risk that has already come to fruition.” *Williams v. Globus Med., Inc.*, 869 F.3d 235, 242 (3d Cir. 2017). “Courts are skeptical” of such companies. *Id.* at 241.

None of the facts about IIPR’s discussion of due diligence are in dispute. IIPR emphasized the importance of due diligence, that it relied on its management, and specifically, Defendant Gold, to carry it out, *see, e.g.*, ¶120, that it did so “on an ongoing basis,” ¶121, that it reviewed financial statements, and that its Construction Team, reporting to Defendant Hastings, checked all Draw Requests and invoices, and only paid when it had “verified” that the work had been performed. ¶176.

Nor are the allegations showing IIPR performed essentially no due diligence in dispute. Defendants read nice things on Kings Garden’s website, Ex. 3 at 4, and concluded they were true. Defendants simply took King’s word that he could get licensed if he wanted to. ¶34. Defendants plainly did no site visits, otherwise they would have seen that the money IIPR provided was not being used for the purposes for which it was given. It failed to look closely at any Draw Requests—the very first one was an obvious forgery, ¶58—and it never called contractors, until just before the end of the Class Period, to verify if work IIPR was paying for had actually been done. ¶60. When IIPR finally called Kings Garden, Kings Garden admitted that it, and not the contractors, had always prepared the Draw Requests. ¶57.

Nor is there any factual dispute that information sufficient to conclude that Kings Garden was a Ponzi scheme was available to IIPR before it ever contracted with Kings Garden, because IIPR admitted in its lawsuit against Kings Garden that it was. ¶63. The Swiss American lawsuit, in January 2019, relying on limited financial records, alleged financial fraud, money disappearing from Kings Garden's accounts, and self-dealing. ¶¶66-67. IIPR had received quarterly financial statements from Kings Garden starting in November 2019. ¶59. King had already been involved with 32 lawsuits before January 2019, already had felony charges, and had already changed his name. ¶63. The information from which IIPR eventually concluded that Kings Garden was a Ponzi scheme with organized crime ties was available in early 2019 with just a few keystrokes.

In *Sheet Metal Workers Nat. Pens. Fund v. Bayer AG*, 2021 WL 4864421 (N.D. Cal. Oct. 19, 2021), Bayer, speaking about its due diligence in investigating legal liability it would inherit related to its purchase of Monsanto, told investors that Monsanto had provided it with “transparency, data and visibility” about the “crucial questions.” *Id.* at 3. But Bayer had simply “accepted at face value Monsanto’s characterization of its legal risks” and “had not reviewed any internal Monsanto documents.” *Id.* Denying the motion to dismiss due diligence claims, the court ruled that Defendants’ statements “could have given a reasonable investor the impression of a state of affairs that differs in a material way from the one that actually exists,”

Id. at *3, quoting *Berson v. Applied Signal Tech., Inc.*, 527 F.3d 982, 985 (9th Cir. 2008), namely that Bayer had reviewed non-public information and had assessed Monsanto’s litigation risks. The *Bayer* court found that though Defendants assured investors that it conducted due diligence, their “diligence was less than what an investor would believe their statement meant.” 2021 WL 4864421, at *3.

Bayer is directly on point. Defendants’ failure to disclose that Kings Garden was a fraud in the context of its warnings about due diligence created an impression that was distinctly different from the truth. IIPR repeatedly warned about the importance of due diligence and that they relied on their management team to carry it out, creating the impression that management was in fact doing that. Defendants’ warnings stated that they did site visits, and conducted due diligence “on an ongoing basis.” Quarter after quarter, Defendants bragged that their investment in Kings Garden was growing, strengthening the impression that due diligence had actually been performed, when in fact investor money was being dropped into a Ponzi scheme. Just as in *Bayer*, Defendants’ risk warnings “created an impression of a state of affairs” that differed significantly from the actual due diligence performed.

Having failed to tell investors that the hypothetical due diligence risks had materialized and that Kings Garden was a fraud, the risk warnings are adequately alleged as false.

2. Defendants' Statements Discussing IIPR's Investment in Kings Garden are Adequately Pleaded as False

Throughout the Class Period, Defendants repeatedly bragged about their increasing investment in Kings Garden and its importance to IIPR's rent revenues. Once a company has chosen to speak on an issue ... it cannot omit material facts related to that issue so as to make its disclosure misleading." *Globus Med.*, 869 F.3d at 241, quoting *Kline v. First W. Gov't Sec., Inc.*, 24 F.3d 480, 490–91 (3d Cir. 1994).

Contrary to Defendants' argument that no fraud occurred before the first Draw Request, every time Defendants spoke about their increasing investment in Kings Garden, or announced that Kings Garden was one of IIPR's largest operators, they were duty-bound not to omit that IIPR was sending investors' money *to a Ponzi scheme with mob ties*. In the absence of this disclosure, IIPR's statements were materially incomplete and actionably false.

For example, in the August 6, 2020, Q2 2020 earnings call, Defendant Gold announced that IIPR had invested at least \$17.5 million in Kings Garden. ¶122. Having invested money in a fraud, and having created the impression that the investment was a positive, Defendants were duty-bound, having discussed due diligence, to tell investors that the risks warned of had materialized, that King was a "fraudster," and that Kings Garden was a Ponzi scheme.

Statements throughout the Class Period are similarly false for failing to disclose that Kings Garden was a fraud.¹³

3. Defendants' Statements Praising Kings Garden are Adequately Pleaded as False

IIPR repeatedly praised Kings Garden, even after the Blue Orca report revealed what actual due diligence could have easily uncovered, including the Swiss American and Paul King lawsuits. Having praised Kings Garden, Defendants' failures to disclose material facts that would render the praise not misleading—that Kings Garden was a Ponzi scheme, King a fraudster, and that from the very first Draw Request, Kings Garden was submitting forged documents to IIPR and stealing from IIPR—rendered those statements materially false.

a) August 7, 2020-April 13, 2022

From the start of the Class Period until the day before the release of the Blue Orca report, all statements of praise were materially misleading. For example, in the Q2 2020 10-Q, ¶122, Defendants praised Kings Garden for its “unique” distribution

¹³ See ¶128 (Q2 2020 disclosures- Kings Garden 10% of IIPR's rental revenue, \$17.5 million investment); ¶135 (2020 10-K- \$70 Million investment); ¶139 (Q2 2020 earnings call- \$150 million investment); ¶142 (5/5/21 press release- IIPR “expanded existing relationship with ... Kings Garden”); ¶151 (Q2 2021 10-Q- Kings Garden 7% of total revenue, top five in revenue for IIPR); ¶¶153-154 (Q2 2021 earnings call- \$150 million investment); ¶160 (Q3 2021 10-Q- Kings Garden 8% of total revenue, top five in revenue for IIPR); ¶166 (2021 10-K- same); ¶172 (Q4 2021 earnings call- \$148 million investment); ¶180 (Q1 2022 10-Q- Kings Garden 7% of total revenue, top five in revenue for IIPR)

of quarterly dividends to its investors. Putting aside that this was a red flag shining in Defendants' faces, which they ignored, and that Swiss American had alleged the exact opposite, having praised Kings Garden, Defendants were duty bound to disclose the that King and Kings Garden were crooks and frauds.

Similar statements throughout the Class Period and before April 14, 2022 are also false for failing to disclose that Kings Garden was a fraud. *See* ¶139 (Q4 2020 earnings call- we are “proud partners of Michael King and his great team,” “thrilled to team with Kings Garden); ¶154 (Q2 2021 earnings call- “we are thrilled with the quality of our tenant roster”); ¶172 (Q4 2021 earnings call- “Kings Garden has [a] truly distinguished brand returns quarterly dividends to investors We are excited to be working closely with Kings Garden”).¹⁴

¹⁴ Defendants argue that specific statements in ¶139 and ¶154 are inactionable puffery. DMem 22-23. Defendants are wrong. The Supreme Court has held that in a commercial context, the use of conclusory terms—“we’re thrilled to team with Kings Garden,” “we are thrilled with the quality of our tenant operators,” —“are reasonably understood to rest on a factual basis that justifies them as accurate.” *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1094 (1991). Here, the statements are rendered false by what was omitted, that IIPR’s thrill was with partnering with a Ponzi scheme and a fraud. In any case, the statements are “not so obviously unimportant to an investor that reasonable minds cannot differ on the question of materiality,” so the fact-specific inquiry should not be decided at this stage. *De Vito v. Liquid Holdings Group, Inc.*, 2018 WL 6891832, at *28 (D.N.J. Dec. 31, 2018).

b) April 14, 2022-August 4, 2022

IIPR's reaction to the Blue Orca report was remarkable. Blue Orca having told the market what Defendants were duty-bound to have disclosed since the start of the Class Period, that Kings Garden and King were running a Ponzi scheme, Defendants' reaction was to deny everything, telling the market that it was all a lie and that Kings Garden was great. Defendants' statement claiming that the Blue Orca report was wrong in its entirety, that IIPR "verified" the accuracy of all Draw Requests, and that the report was of such little value that it "does not warrant a response from IIP," ¶114, is false for contradicting the due diligence information the Blue Orca report's author had compiled. With proof published that King and Kings Garden were frauds before they ever even met Defendants, their failure to disclose the truth was actionably false.

Defendants published further materially false statements during the Q1 2022 earnings call on May 5, 2022. ¶182. Failing to mention the Blue Orca report, Defendant Regin praised Kings Garden for their "highly unusual" quarterly dividends, failing to state that both Swiss American and Paul King had filed lawsuits alleging financial malfeasance and funds disappearing improperly from Kings Garden's accounts. ¶182. Griffin Marquart, IIPR's Director of Construction Management, discussed King's Garden's continued growth, and its Draw Requests in San Bernardino for \$27.1 million, without ever mentioning that the Draw

Requests were obvious forgeries, starting from the very first Draw Request in mid-2021. ¶183. Finally, Defendant Gold went all-in, praising Kings Garden and King specifically as having “the best reputations,” and as “high-quality.” ¶184. All of these statements are false for Defendants’ failures to disclose that Kings Garden and King were frauds and thieves. On July 14, 2022, IIPR filed a form 8-K disclosing that Kings Garden had defaulted on the entirety of its July 2022 rent. ¶186. This statement is materially false for IIPR’s failure to disclose that Kings Garden was a Ponzi scheme into which IIPR had invested \$150 million.

4. The Complaint Adequately Pleads GAAP Violations

Defendants argue that the Complaint does not adequately plead IIPR’s GAAP violations. DMem 23-25. They are wrong.¹⁵ With respect to GAAP requiring IIPR to impair the carrying values of its real estate investments, ¶¶93-110, Defendants never mention impairment, much less discuss it. The Complaint identifies the GAAP provision at issue (ASC 360), details why impairment was necessary, details exactly how it impacted (in IIPR’s favor) the financial statements, hiding IIPR’s true financial position and lending activities from investors. Importantly, impairment was mandated *because Kings Garden was a Ponzi scheme!* Defendants bragged that they evaluated their tenants’ creditworthiness *on an ongoing basis*. ¶121. Defendants’ failure to impair the assets supports a finding of falsity.

¹⁵ See ¶¶81-114, 124-125, 130-131, 137-138, 147-148, 156-157, 162-163, 170-171.

With respect to the carrying values of properties IIPR purchased from Kings Garden, the Complaint identifies the GAAP provision that IIPR violated (ASC 842), that it was required not to record the entire purchase price as the fair value, and details exactly how it impacted (in IIPR's favor) the financial statements, hiding IIPR's true financial position and lending activities from investors.

“Allegations that accounting rules are straightforward and the company's accounting treatment was obviously wrong may create an inference of scienter.” *S.E.C. v. Egan*, 994 F. Supp. 2d 558, 565 (S.D.N.Y. 2014) (internal quotation omitted). This is precisely what the Complaint alleges. As explained in the Complaint, ASC 842 includes a straightforward, plain language example of how to account for fair value in a sale-leaseback transaction. ¶90. As the Complaint details, IIPR's sale-leaseback transactions closely fit the fact pattern in the example, and IIPR misapplied straightforward GAAP. ¶¶86-92. The falsity of the GAAP violations is adequately alleged.

B. The Complaint Adequately Pleads Scienter

Ignoring altogether the Complaint's well-pleaded allegations—including their own admissions—and relying on inapposite cases, Defendants contend that the Complaint fails adequately to plead scienter. Evaluating all of the allegations holistically, the Complaint, however, adequately pleads Defendants' scienter.

Recklessness is “not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.” *Institutional Invs. Grp. v. Avaya, Inc.*, 564 F.3d 242, 267 n.2 (3d Cir. 2009) (reversing dismissal, in part, finding complaint adequately pleaded recklessness) (citation omitted). Stated plainly, this Court must determine whether Defendants’ conduct was an extreme departure from the standards of ordinary care or whether they were profoundly incompetent.

The Complaint must plead with particularity a strong inference of scienter. *Id.* Allegations of motive neither suffice on their own to establish a strong inference nor are necessary. *Tellabs*, 551 U.S. at 325. Rather, “courts must consider the complaint in its entirety,” including motive allegations or lack thereof, “as well as . . . documents incorporated into the complaint by reference, and matters of which a court may take judicial notice,” to 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.” *Id.* at 322-23 (emphasis in original) (citations omitted).

This Court will weigh “plausible, nonculpable explanations” against the inference a complaint pleads, but the strong inference “need not be irrefutable, *i.e.*, of the “smoking-gun” genre, or even the “most plausible of

competing inferences.” *Id.* at 323-24 (citations omitted). The Complaint survives if “the inference of scienter is cogent and at least as compelling as any opposing inference one could draw from the facts alleged.” *Id.* at 324.¹⁶ Viewed holistically, the inference that Defendants acted recklessly is cogent and at least as compelling as the inference that they are profoundly incompetent.

1. The Complaint Adequately Pleads Serial, Severely Reckless Conduct

The multiple instances of willful blindness the Complaint particularizes constitute a pattern of extreme departures from the standards of ordinary care. Viewed holistically and in context of Defendants’ own warnings about the cannabis industry and the tens of millions of dollars IIPR committed to Kings Garden, it is cogent and at least as compelling as any counter-inference that Defendants’ conduct was severely reckless.¹⁷

Defendants assert that the Complaint alleges access to information but fails to “specifically identify the reports or statements containing this information.” DMem 31-32 (citing *In re Intelligroup Sec. Litig.*, 527 F. Supp. 2d 262, 286 (D.N.J. 2007))

¹⁶ The Supreme Court added that while “omissions and ambiguities count against inferring scienter . . . , [w]e reiterate, however, that the court’s job is not to scrutinize each allegation in isolation but to assess all the allegations holistically. *Tellabs*, 551 U.S. at 326. The Third Circuit added, an “inference is not arithmetic. The inferential significance of any single allegation can be determined only by reference to all other allegations.” *Avaya*, 564 F.3d 267 n.2.

¹⁷ Defendants’ counter-inference is that they were monumentally incompetent.

(citing *Novak v. Kasaks*, 216 F.3d 300, 311 (2d Cir. 2000) (access to facts undermining statements or failing to check information they had a duty to monitor suffices for strong inference)). A complaint must plead with particularity both that material adverse information existed, belying Defendants’ public statements, and the nature of Defendants’ access thereto. *Strougo v. Mallinckrodt Plc*, 2022 WL 17740482, at *8 (D.N.J. Dec. 16, 2022) (denying dismissal finding scienter because defendants had access to adverse information from due diligence). The Complaint particularizes multiple instances of both the adverse information available and Defendants’ access to it, supporting a strong inference of recklessness.

For example, Defendants’ due diligence statement is actionable because material adverse information existed at the time and Defendants had access to it. *Blank v. TriPoint Glob. Equities, LLC*, 338 F. Supp. 3d 194, 215 (S.D.N.Y. 2018) (denying dismissal, ruling that claiming due diligence when defendant conducted none is “an extreme departure from the standards of care”) (citation omitted). The facts surrounding Defendants’ failure to conduct due diligence support a strong inference of scienter.¹⁸ Here, the Swiss American lawsuit from January 29, 2019—

¹⁸ Defendant Gold told investors that IIPR spent “a great deal of time focus[ed] not only on the . . . proposed real estate transaction,” but “a lot of time with the management team” doing “background checks on these tenants, understanding where they’ve come from and their reputations” ¶33. Defendants concede this lie, stating that they “relied heavily” on Kings Garden’s California license and its “reputation in the cannabis industry” Ex. 3, ¶19.

three months before IIPR first contracted with Kings Garden—alleged substantially similar conduct to that Defendants themselves claim to have discovered in 2022. Michael King and Kings Garden had a history of sketchy financial dealings, self-interested transactions, and a penchant for disappearing assets. ¶¶59, 63; Ex. 4 at 1, 3. IIPR intended to lend Kings Garden tens of millions of dollars. A simple search would have revealed the Swiss American proceeding among the many others.¹⁹

Rather than confirming the backgrounds of the Kings Garden management team, as they claimed to have done, ¶6, Defendants simply accepted King's representations and purportedly relied on California's licensing process when King, himself, had no license. ¶34; Ex. 3 at 5.²⁰ The information Defendants discovered about King's past, however, was both accessible and materially adverse. Either they searched and discovered the information or they did not search. Thus, at the time of IIPR's first contract with Kings Garden, Defendants' failure to perform even rudimentary due diligence was an extreme departure from the standards of ordinary care. *See Blank*, 338 F. Supp. 3d at 215; *see also In re Stable Road Acquisition Corp.*,

¹⁹ *See* Ex. 4 at 5, 17 (Defendants found a name change, 32 lawsuits, felony charges, and alleged fraudulent conduct). *See Bishins v. Cleanspark, Inc.*, 2023 WL 112558 *10 (S.D.N.Y. Jan. 5, 2023) (denying dismissal, finding scienter where plaintiff specifically identified information to which defendants had access).

²⁰ Defendants' description of the cannabis industry renders their failure to conduct due diligence even more of an extreme departure from the standards of ordinary care. *See, e.g.*, ¶89 (uncertain regulatory environment and limited history of tenants).

2022 WL 2762213, at *11-12 (C.D. Cal. July 13, 2022) (denying dismissal, ruling failure to investigate security issues of target’s principal is reckless).²¹

Alone, Defendants’ failure to conduct any meaningful due diligence suffices, but their conduct deteriorated as the Class Period began. Ignoring red flags of which a defendant is aware supports a finding of recklessness. *See In re Aphira, Inc. Sec. Litig.* 2020 WL 5819548, at *9 (S.D.N.Y. Sept. 30, 2020) (denying dismissal, ruling that information that was or should have been uncovered in due diligence was “critical to the acquisition,” supporting finding of recklessness). A defendant’s failure to review or check information they have a duty to monitor or ignoring obvious signs of fraud suffice to allege recklessness. *Novak*, 216 F.3d at 308. Having failed to conduct due diligence on Kings Garden and King in advance of the April 2019, transaction, Defendants ignored multiple red flags throughout the Class Period of which they were aware or to which they had access.

For example, in June 2020, Defendants learned that Kings Garden was purportedly paying a dividend, cash on-hand to owners. At the time, Defendants

²¹ *GSC Partners CDO Fund v. Washington*, 368 F.3d 228 (3d Cir. 2004) supports denying dismissal here. The Third Circuit described due diligence as “thorough scrutiny.” *Id.* at 232. The acquirer’s due diligence consisted of a month of interviews, document review, site visits, and questions to the target. *Id.* at 233. Even as the acquirer’s due diligence team expressed concerns about projections, they expressed confidence acquirer had the experience to turn around the target. *Id.* at 234. Affirming dismissal, the Third Circuit ruled the complaint failed to connect what the defendants learned in due diligence with any alleged fraudulent statement. *Id.* at 239. Here, the material adverse information is inextricably linked to the false statements.

described those payments as “[n]otabl[e] and highly unique in this industry,” ¶¶48, 122, touting the dividend Kings Garden purportedly paid as “a remarkable achievement for a company continuing on its rapid expansion path.” ¶139.²² Later, in May 2022, Defendants described the purported dividend as “highly unusual among any prominent brand in the industry,” ¶49.²³

Thus, by mid-2020, after the first contract and after having spent tens of millions on Kings Garden properties, ¶122—but before IPR paid the first Draw Request—Defendants knew that Kings Garden had purportedly engaged in highly unusual conduct.²⁴ Not only was it unusual, however, but, according to Swiss American, Kings Garden did not pay its unit holders. ¶66. In the context of Defendants’ failing to perform due diligence, this red flag concerning payments to “shareholders” coupled with Swiss American’s January 2019 allegations that Kings Garden refused to pay its unit holders connects directly to Defendants’ claimed July 2022 discovery that money was missing from Kings Garden. *See* ¶62. Defendants’

²² A red flag that is either public or publicly available can contribute to a strong inference of scienter. *Sun v. Han*, 2015 WL 9304542 (D.N.J. Dec. 21, 2015) (citing *In re Suprema Specialties, Inc. Sec. Litig.*, 438 F.3d 256, 280 (3d Cir. 2006)).

²³ Even after the Blue Orca report, Defendants portrayed the dividend positively. ¶182 (dividend “demonstrates [*Kings Garden’s*] *belief* in the long-term prospects in the business.” ¶182 (emphasis added)).

²⁴ Even as Defendants failed to conduct any meaningful due diligence in 2019, the Class Period begins in August 2020, *after* Defendants learned that Kings Garden engaged in “unique,” “highly unusual” behavior, a red flag they ignored.

ignoring the purported dividend is strong circumstantial evidence of an extreme departure from the standards of ordinary care. *See Schueneman v. Arena Pharms., Inc.*, 840 F.3d 698, 707–709 (9th Cir. 2016) (reversing dismissal, finding that expressing confidence with knowledge of “highly unusual” contact with FDA supports a strong inference); *Sjunde AP-Fonden v. Goldman Sachs Grp., Inc.*, 545 F. Supp. 3d 120, 130, 142 (S.D.N.Y. 2021) (highly unusual or suspicious deal terms indicate red flag “suggestive of fraud”).

Red flags, however, persisted throughout the Class Period. For example, Kings Garden began providing financial statements in November 2019. ¶59. During the Class Period those financial statements showed millions of dollars disappearing from Kings Garden’s accounts, with no obvious explanation. ¶8. Defendants admit that financial statements IIPR possessed and that they claim only belatedly to have reviewed, showed “loan payoffs” and “examples of millions of dollars leaving [Kings Garden] to unknown individuals,” Ex. 3, ¶34, a glaring red flag. Defendants’ possession of Kings Garden’s suspicious financial statements further supports a strong inference of an extreme departure from the standards of ordinary care. *See Goldman Sachs*, 545 F. Supp. 3d at 143 (considering three red flags involving fees, no-bid structure, and private placements suffices for recklessness).

Further, and critically, Defendants assumed a duty to monitor Kings Garden's Draw Requests and other credit quality information,²⁵ rendering their failure reckless. The Complaint pleads with particularity that Defendants possessed information that was "so obvious that they must have been aware of it." Defendants admit that they received the first Draw Request on or around July 29, 2021. Ex. 3, ¶25. They admit that the Draw Requests required, among other information the signatures of the general contractor and the architect, yet the second Draw Request did not contain an architect's signature. Ex. 3, ¶23. On its face, therefore, that Draw Request was deficient. Either Defendants called the contractor or architect to verify the Draw Request and knew it was fraudulent or their failure constitutes an extreme departure from the standards of ordinary care.

Worse still, in July 2021, in support of the first Draw Request, Kings Garden transmitted to Defendants forged invoices for electrical work. Ex. 3, ¶¶33-34. Even as Defendants claim that the invoices "appeared authentic on their face," Ex. 3, ¶33, their own description and reproduction of the invoice belies that claim.²⁶ The first

²⁵ Defendants boasted that they evaluated Kings Garden's credit quality "on an ongoing basis," continuing that "in some instances, we monitor our tenants by periodically conducting site visits and meeting with the tenants to discuss their operations." *See e.g.*, ¶121. Reasonably monitoring Kings Garden's credit quality must include searches for liens and lawsuits that impact the business and its ability to pay rent. Before the first Draw Request, however, Paul King had sued King and Kings Garden for misusing funds and defrauding investors. ¶68.

²⁶ *See* Ex. 4 at 16 (Defendants call invoice issues "alarming irregularities").

Draw Request Kings Garden forged contained “inconsistent type fonts and text boxes that appeared to have been added to an old invoice” The pdf contained metadata showing that the invoice dated from five years before the Draw Request, and it “appeared to be based on a document from an electrical company previously owned directly by” Kings Garden’s VP of operations. Ex. 3, ¶33.²⁷ With respect to the Draw Requests, once again, the Complaint pleads with particularity material adverse information in Defendants’ possession or to which they had access. Given that Defendants had information in their possession that was both incomplete and suspicious—on its face—either they knew by mid-2021 that Kings Garden was a fraud or their departure from the standards of ordinary care was extreme. *Bishins*, 2023 WL 112558, at *10.

Last, Defendants’ bad faith reaction to the Blue Orca report strongly supports a finding of fraudulent intent. *See Indiana Public Ret. Sys. v. AAC Hldgs, Inc.*, 2021 WL 1316705 *8 (M.D. Tenn. Apr. 8, 2021) (denying dismissal, finding scienter in part because SEC subpoena was a red flag, putting defendants on notice of accounting problems). Defendants dismissed the Blue Orca report, stating Blue Orca did “not understand the process that IIP employs for underwriting those improvements, and that *any IIP reimbursements relate only to verified, qualified*

²⁷ So much for “background checks on these tenants, understanding where they’ve come from and their reputations.” ¶33.

improvements to the buildings for these purposes, and never as funding for any type of ‘loan’ to be utilized for any other purpose.” ¶176. On the face of IIPR’s complaint, however, IIPR and its 18 employees did not verify the Draw Requests, did not contact contractors and architects, and did not visit Kings Garden’s sites. Immediately, the Blue Orca report put all Defendants on notice, making them “‘specifically aware’ of several of the red flags that [Blue Orca] raised,” constituting “‘obvious signs of fraud’ that Defendants should not have ignored.” Their conscious disregard of the red flags establishes recklessness. *Goldman Sachs Grp.*, 545 F. Supp. 3d at 144 (denying dismissal, finding red flags that defendants ignored sufficed to plead a strong inference) (citing *In re Alstom SA*, 454 F. Supp. 2d 187, 201 (S.D.N.Y. 2006); *Novak*, 216 F.3d at 308; *In re Doral Fin. Corp. Sec. Litig.*, 563 F. Supp. 2d 461, 466 (S.D.N.Y. 2008)).

Inexplicably, however, three weeks later—with time enough to call contractors and architects and to scrutinize financial statements and Draw Requests—Defendants doubled down, describing, again, the dividend Kings Garden paid as supporting “their belief in the long-term prospects in the business,” ¶182, boasting of the \$45 million they had dispensed for improvements in two Kings Garden projects, ¶183, and praising the reputation of “King and his team . . . for product quality and consistency” ¶184. In those three weeks, Defendants had actual knowledge of the Swiss American and Paul King lawsuits, possessed suspicious

financial statements, had ample time to scrutinize the incomplete Draw Requests and the doctored invoices, to call contractors and architects, and to insist on site visits. Defendants' doubling down supports a strong inference that they were severely reckless during the entire Class Period. *See In re Navient Corp. Sec. Litig.*, 2019 WL 7288881 *10 (D.N.J. Dec. 30, 2019) (denying dismissal, finding that knowledge of lawsuits and statements about baselessness supports a finding of recklessness). Together, Defendants' failure to conduct due diligence, their ignoring multiple red flags, their dismissing the Blue Orca report, and their doubling down on their support for Kings Garden represent an extreme departure from the standards of ordinary care, supporting a strong inference of their recklessness.²⁸

2. GAAP Allegations Support a Strong Inference of Recklessness

Defendants further assert that the GAAP allegations fail to support an inference of scienter. DMem 34. Alone, GAAP violations do not. Together with the multiple red flags the Complaint pleads about Kings Garden, however, IIPR's

²⁸ Only by ignoring the Complaint's well pleaded allegations can Defendants argue that the Complaint "cannot support an inference of scienter by pointing to the fraud committed by Kings Garden *against* IIPR because it is not evidence of any fraud *by* IIPR." DMem 34-35. The Complaint does not allege only that Kings Garden is a fraud and therefore IIPR committed fraud. Rather, it particularizes the "more," specific facts showing that the defendants either knew about the Kings Garden fraud or recklessly disregarded it. *SLF Hldgs, LLC v. Uniti Fiber Hldgs, Inc.*, 499 F. Supp. 3d 49 (D. Del. 2020), *aff'd*, 2022 WL 3442353 (3d Cir. Aug. 17, 2022) and *Christian v. BT Grp. Plc*, 2020 WL 1969941 (D.N.J. Apr. 24, 2020) are inapposite for the plaintiffs' failure to include the "more."

GAAP violations further support Defendants’ extreme departure from the standards of ordinary care. *Oregon Laborers Employes Pension Trust Fund v. Maxar Tech., Inc.*, 2020 WL 5500458 *15 (D. Colo. Sept. 11, 2020) (denying dismissal, finding that allegations of GAAP violations coupled with particularized red flags adequately pleads scienter). With the particularized red flags and material adverse information the Complaint pleads about Kings Garden, and Defendants’ ultimate assessment that King was a fraudster and Kings Garden a Ponzi scheme, for example, Defendants knew or had access to information suggesting that the carrying value of Kings Garden was impaired. In addition, their failures to conduct due diligence initially, ¶120, or to assess Kings Garden’s credit quality on an ongoing basis, ¶121, caused them improperly not to re-assess the carrying values for all of IIPR’s tenants.²⁹

More, “a clean audit opinion does not categorically insulate a defendant from liability, and the Court will consider Plaintiff’s other allegations as to scienter.” *Roofers’ Pension Fund v. Papa*, 2018 WL 3601229 *19-20 (D.N.J. July 27, 2018). Nothing of record supports that BDO knew or had reason to know that King was a fraudster and Kings Garden a Ponzi scheme or of the red flags that existed before

²⁹ In *Intelligroup*, 527 F. Supp. 2d at 286-87, the court compared cases alleging GAAP violations with nothing “more,” citing *Rothman v. Gregor*, 220 F.3d 81 (2d Cir. 2000), with cases where the complaints alleged “more,” including that defendants “knew facts or had access to information suggesting that their public statements were not accurate.” (citing *Novak*, 216 F.3d). For the reasons stated above, here, the Complaint alleges “more.”

and during the Class Period. More, Defendants lied to investors about “verified, qualified improvements,” ¶176, so it is reasonable to infer at the pleading stage that that they lied to BDO about verifying the reimbursements to Kings Garden. As such, BDO’s opinion is irrelevant to the scienter analysis and the GAAP allegations support a strong inference of scienter.

3. Motive Allegations Support Strong Inference of Scienter

Defendants assert that the Complaint fails to plead a motive. DMem 28-30. Plaintiffs do not assert that motive alone suffices to plead a strong inference. As noted above, however, the absence of motive is not dispositive.³⁰ Courts should consider motive with the Complaint’s other allegations in the holistic analysis *Tellabs* requires. *Avaya*, 564 F.3d at 277. Motive allegations that “relate to a particular statement” may enhance a strong inference. *Id.* Here, the Complaint demonstrates motive and relates it to the fraud, supporting a strong inference.

By the beginning of the Class Period, Defendants had trapped themselves.³¹ They knew and warned that replacing Kings Garden after default would require time,

³⁰ The Complaint does not attempt to show motive by reference to IIPR’s tax status as a REIT. DMem. 28 (citing ¶29).

³¹ Defendants deem “economically irrational” their “knowingly” allowing Kings Garden to defraud IIPR. DMem. 39 (theory “does not make sense”). After no due diligence and abundant red flags, resulting in tens of millions spent, it is not economically irrational to delay a reckoning given the difficulty of replacing tenants, the material possibility of total loss, and the reputational hit. *See Dow Corning Corp. v. BB&T Corp.*, 2010 WL 4860354 *11(D.N.J. Nov. 23, 2010) (citation omitted) (denying dismissal, finding it rational to pump demand in attempt to buy time to exit

substantial costs to protect its investment, and possibly materially lower rents or outright loss. ¶168. By May 2020, Defendants had caused IIPR to pay more than \$44 million to purchase properties from Kings Garden.³² In the face of suspicious conduct, Defendants’ incentive—their motive—was to avoid recrimination from analysts and investors for the tens of millions they caused IIPR to spend on Kings Garden. As long as Kings Garden paid rent—most likely from the proceeds of its cash haul from IIPR—Defendants were motivated to continue their extreme departure from the standards of ordinary care. The Complaint, therefore, ties Defendants’ motive directly to their false statements about Kings Garden. This motive supports a strong inference that Defendants acted recklessly.

In addition, IIPR’s Proxy statements during the Class Period demonstrate that IIPR’s compensation committee considers “deploying capital” as a factor in determining the Individual Defendants’ compensation.³³ Given the “limited number

market); *see also Indiana Pub. Ret. Sys. v. SAIC, Inc.*, 818 F.3d 85, 97 (2d Cir. 2016) (citation omitted) (delaying reckoning plausible where benefit of concealment may exceed costs). Defendants’ response to the Blue Orca report supports that they were motivated to delay the day of reckoning. *In re Adolor Corp. Sec. Litig.*, 616 F. Supp. 2d 551, 572 (E.D. Pa. 2009) is inapposite. That court found that lying about one study but not about another study for the same drug made no sense. No such inconsistency exists here.

³² *See* ¶182 (\$27 million April 2019 purchase and \$17.5 million May 2020 purchase).

³³ *See* Haklay Decl., Exs. B, C, and D (compensation committee bases compensation in material part on IIPR’s performance, including “deployment of capital” as a critical metric). Even as the Complaint does not reference these proxy statements, not only can the Court consider them without converting Defendants’ motion to one

of tenants,” ¶168, deploying capital in this space presents material challenges. The Individual Defendants benefitted directly from deploying capital. The Complaint alleges that Defendants’ extreme departure from the standards of ordinary care occurred with respect to IIPR’s deploying capital to Kings Garden, a Ponzi scheme. As such, the enhancement to Defendants’ compensation from deploying tens of millions of dollars to Kings Garden further supports a strong inference that they acted recklessly. *In re Novo Nordisk Sec. Litig.*, 2018 WL 3913912 *4, *8 (D.N.J. Aug. 16, 2018) (denying dismissal, finding share-based compensation structure tying compensation to fraud contributes to strong inference of scienter).

4. The Complaint Adequately Pleads the Scienter of All Defendants

Again, ignoring the Complaints particularized allegations, Defendants contend that the Court should not infer scienter based solely on the Individual Defendants’ positions at IIPR. DMem at 37-38. Relatedly, they claim that the Complaint fails to plead IIPR’s scienter for its failure to plead a strong inference with respect to any of the Individual Defendants. DMem 26-28. They are wrong.

for summary judgment, but can consider them in its scienter analysis. *Oran v. Stafford*, 226 F.3d 275, 289 (3d Cir. 2000) (taking judicial notice of proxy statement filed with SEC even though not presented to district court).

By way of background, during the Class Period, IIPR had only 15-18 employees, total.³⁴ The eight-person management team,³⁵ mostly Defendants here, led IIPR. Defendants described that Defendant Gold led their “experienced and committed management team” in acquisitions, dispositions, construction, development, management, finance and capital markets.”³⁶ Defendants stated that they “me[et] regularly as a full team, including throughout the COVID-19 pandemic, where each member is encouraged to actively participate in a wide range of topics relating to our company’s execution.”³⁷ ¶120. They stated publicly that the management team performed due diligence and investigations, ¶47, including “do[ing] background checks on these tenants, understanding where they’ve come from and their reputations in the specific state or just in the industry in general.” ¶33. *See Allegheny Cnty. Employees' Ret. Sys. v. Energy Transfer LP*, 532 F. Supp. 3d 189, 228–230 (E.D. Pa. 2021) (denying dismissal, finding scienter for individuals with detailed knowledge of a process and/or personally oversaw project).

Against that background, before the Class Period, Individual Defendants—the team they, themselves, boasted conducted due diligence and background checks

³⁴ DEx. A at 7 (15 full time employees as of 12/31/2020); DEx. B at 7 of 183 (18 full time employees as of 12/31/2021)

³⁵ <https://innovativeindustrialproperties.com/iip-our-team/>.

³⁶ DEx. B at 10 of 183.

³⁷ DEx. B 32 of 183.

but did not—knew that they had relied on King’s and Kings Garden’s representations, principally. With their experience in acquisitions, each Individual Defendant knew, therefore, that IPR did no real due diligence. Prior to the Class Period, each had access to the Swiss American proceeding and Kings Garden’s suspicious financial statements. More, at the beginning of the Class Period, with Defendants Gold, Smithers, and Hastings present,³⁸ Defendant Regin disclosed publicly that Kings Garden paid a dividend, calling it “highly unique.” ¶122.

Thus, each Individual Defendant participated in the acquisitions of Kings Garden properties, had access to the Swiss American proceeding and had actual knowledge of the “highly unique” dividend—a red flag. *Stable Road*, 2022 WL 2762213 at *12 (finding scienter allegations adequate for individual defendant who was aware of red flags but inadequate for those who were not). From there, each Individual Defendant had access to the financial statements Kings Garden provided, and, ultimately to the Draw Requests. Far from alleging that they acted recklessly solely because of their position, the Complaint pleads with particularity the facts to which each Individual Defendant had access and of which they had actual knowledge. In other words, the Complaint adequately alleges each Individual Defendant’s scienter with particularity. *Mallinckrodt*, 2022 WL 17740482 at *9

³⁸ See <https://seekingalpha.com/article/4365468-innovative-industrial-properties-inc-iipr-ceo-paul-smithers-on-q2-2020-results-earnings-call>.

(rejecting argument that complaint lumped together individual defendants and alleged a “collective state of mind”).³⁹

Last, even if the Court finds Defendants’ incompetence more compelling an inference than their recklessness prior to the Blue Orca report, ¶174, after, Defendants have no cogent, competing inference whatsoever. Through the Blue Orca report, to which Defendants publicly responded, ¶176, Defendants possessed actual knowledge of the Swiss American and Paul King proceedings. They also had access to the Draw Requests and forged invoices, and Kings Garden’s financial statements, showing suspicious payments and loans. Rather than remain silent and investigate, Defendants responded immediately, dismissing the Blue Orca report and claiming to have “verified” disbursements to Kings Garden. *Id.* Three weeks later, Defendants had had ample time to investigate and to perform due diligence, including background checks. They had time actually to review the suspicious information in their possession, containing “alarming irregularities.” Showing

³⁹ The Court should, therefore, impute the scienter of the Individual Defendants to IIPR. Alternatively, even if the Court finds that the Complaint does not plead the Individual Defendants’ scienter, the Complaint adequately pleads IIPR’s “corporate scienter.” The Construction Team, who reported to Defendant Hastings, purportedly reviewed and verified Draw Requests for accuracy and compliance with acceptable construction parameters. ¶51. As such, the Construction Team and Hastings furnished information that ultimately impacted IIPR’s public statements about Kings Garden. *In re Cognizant Tech. Solutions Corp. Sec. Litig.*, 2020 WL 3026564 *25-28 (D.N.J. June 5, 2020) (even under “narrow approach,” approving payments to contractor supports finding of furnishing information for corporate scienter).

conduct boarding on knowing intent to deceive, Defendants doubled down.⁴⁰ Defendants Gold and Regin and IIPR's Director of Construction consumed material time during IIPR's first quarter earnings call, describing Kings Garden's purported improvements and praising King's and Kings Garden's reputation. ¶¶182-184.⁴¹ It is beyond peradventure that Defendants' knowledge of Swiss American's and Paul King's allegations of fraud and improprieties at Kings Garden, together with possession of and access to information from Kings Garden with "alarming irregularities," suffices to plead that from April 14, 2022, Defendants were reckless.

For all of the foregoing reasons, therefore, considering the Complaint's allegations and documents it can consider holistically, this Court should find that the inference of Defendants' scienter is cogent and at least as compelling as any competing, non-culpable inference.

⁴⁰ In the face of all they knew and to which they had access after the Blue Orca report, Defendants' conduct after April 14, 2022, obliterates their claim to incompetence prior to the Blue Orca report. That is, Defendants' willingness to deceive in the face of public disclosure of material problems with Kings Garden strongly supports that they acted with scienter before April 14, 2022.

⁴¹ Construction Director Marquart either visited the sites and knew about the fraud or lied about visits so did not know which projects Kings Garden had begun or completed or what materials it had ordered. *Compare* ¶183 (disbursements for design, permitting, demolition, and material procurement and new steel structure and metal decking installed in San Bernadino and grading cite for pad certification at 19th Street) *with* Ex. 4 at 17 (upon contacting contractors, Construction Team learned no work performed and upon visiting sites, material difference between work performed and Draw Requests).

IV. CONCLUSION

For the foregoing reasons, Defendants' Motion to Dismiss the Complaint should be denied in its entirety.

Dated: January 25, 2023

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CERTIFICATE OF SERVICE

I hereby certify that on this 25th day of January 2023, I electronically filed the foregoing *Plaintiffs' Memorandum of Law In Opposition to Defendants' Motion to Dismiss the Amended Class Action Complaint for Violations of the Federal Securities Laws* with the Clerk of Court using the CM/ECF system, which will send notification of such to all CM/ECF participants.

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