No. 20-222

IN THE

Supreme Court of the United States

GOLDMAN SACHS GROUP, INC., ET AL.,
Petitioners,

v.

ARKANSAS TEACHER RETIREMENT SYSTEM, ET AL.,
Respondents.

On Writ of Certiorari
to the United States Court of Appeals
for the Second Circuit

BRIEF OF BETTER MARKETS, INC., AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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INTEREST OF *AMICUS CURIAE* [1]

Better Markets, Inc. ("Better Markets") is a nonprofit, non-partisan organization that promotes the public interest in the financial markets through comment letters, litigation, independent research, and public advocacy. It fights for a stable financial system, fair and transparent financial markets, and measures that protect investors from fraud and abuse.

A principal goal of Better Markets' advocacy is ensuring that large financial institutions such as Goldman Sachs are held accountable when they engage in fraud and other misconduct that harms investors. For example, Better Markets has published reports detailing the recidivist pattern exhibited by the nation's largest Wall Street banks. Those reports encompass the alleged violations by Goldman Sachs that are at issue in this case, as well as more recent misconduct. *See, e.g.*, Better Markets, *Goldman Sachs' 1MDB "Four Monkeys" Defense and CEO Solomon's Golden Opportunity* (Apr. 25, 2019).

Better Markets' pursuit of transparency and accountability in finance is also exemplified by its lawsuit against the Department of Justice challenging the ineffective and secretive settlement struck with JPMorgan Chase & Co. over its role in the 2008 financial crisis. *See Better Markets, Inc. v. United States Dep't of Justice*, 83 F. Supp. 3d 250 (D.D.C. 2015). And Better Markets' advocacy has focused

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[1] Pursuant to Supreme Court Rule 37.6, counsel for *amicus curiae* states that no counsel for a party authored this brief in whole or in part. No counsel or party made a monetary contribution intended to fund the preparation or submission of this brief, and no person other than *amicus* or its counsel made such a contribution. All parties have consented to the filing of this brief.

specifically on the important role of class action litigation as the most effective, and often the only, mechanism that can afford meaningful remedies to investors harmed by fraud, abuse, and conflicts of interest. *See, e.g.,* Brief of *Amicus Curiae* Better Markets, Inc., in Support of the Plaintiff-Appellee and Affirmance, *Ford v. TD Ameritrade* (8th Cir., filed May 8, 2019) (No. 18-3689).

In addition, Better Markets has fought for the application of a powerful fiduciary standard to all financial firms dispensing investment advice to retail investors, one that requires advisers to avoid or mitigate conflicts of interest and always act solely in their clients' best interest. *See, e.g.*, Brief of *Amicus Curiae* Better Markets, Inc., and the Consumer Federation of America in Support of Petitioners, *XY Planning Network, LLC v. United States Sec. & Exch. Comm'n*, 963 F.3d 244 (2d Cir. 2020) (No. 19-2886).

Better Markets has an interest in this case because a ruling in favor of Goldman Sachs on the issues presented would undermine the very type of accountability in the financial markets that Better Markets has long pursued. It would short-circuit a meritorious class action seeking recovery for abuses that injured countless investors and helped seed the 2008 financial crisis. In addition, such an outcome would more generally undermine the ability of future plaintiffs alleging securities fraud to establish class certification and present their claims for relief on the merits.

SUMMARY OF ARGUMENT

The Goldman Sachs Group, Inc. is a well-known American investment banking and financial services firm that has achieved tremendous growth. Part and parcel of Goldman Sachs' history, particularly

recently, is also its mixed track record handling conflicts of interest – namely the practice of saying or selling one thing (to its shareholders or clients), and doing another (internally or for its own account). This is an often underappreciated component of the firm's trajectory and is relevant to the course of the litigation at bar.

While this brief does not weigh in on the specific merits of how *Basic Inc. v. Levinson* should be interpreted, it aims to shed light on the historical setting in which this case arises. That broader context is important as this Court examines Goldman's supposition that its statements and practices about conflicts-management were either immaterial to investors, generic, and/or typical for the industry.

Particularly after Goldman went public in 1999, it assumed conflicting roles in large transactions. In the run up to the 2008 financial crisis, Goldman specifically exhibited such behaviors: it simultaneously promoted mortgage-backed securities to clients, bet against them with Goldman's own funds, and received fees to design exotic securities it used to short mortgage markets – all the while assuring its clients it was handling conflicts appropriately. That latter conflict is the subject of this case.

The questionable handling of these conflicts has been the subject of investigation, litigation, and federal enforcement actions.

The banking sector, of course, is not immune from conflicts of interest, especially as some financial services and products overlap after the repeal of the Glass–Steagall Act. The central question is how different firms handle those conflicts. History and regulatory enforcement teach us that when financial institutions do encounter conflicts, they should

carefully manage them – through robust disclosures, firewalls, separate teams, clear policies, and robust internal monitoring and enforcement – lest they mislead and harm their shareholders or clients, or potentially court financial disaster.

ARGUMENT

I. INVESTORS WOULD HAVE BEEN INTERESTED IN GOLDMAN'S SYSTEM FOR MANAGING CONFLICTS GIVEN ITS HISTORY.

Goldman Sachs bears the namesakes of its founder, Marcus Goldman, who came to America in 1848, fleeing revolutions in the German states, initially sold wares out of a horse-drawn cart, and then hung out his shingle to broker commercial paper. *See generally* Stephen Birmingham, *Our Crowd: The Great Jewish Families of New York* (1st ed. 1967).

A century and a half later, the meteoric rise of Goldman Sachs is *sui generis,* and the company has become a household name. Several Goldman alumni have become Secretary of the U.S. Treasury, advised Presidents of both parties, and served in a range of other senior government positions. *See, e.g.,* DealBook, *The People From Goldman Sachs*, N.Y. Times, Mar. 16, 2017, https://www.nytimes.com/2017/03/16/business/dealbook/goldman-sachs-goverment-jobs.html. In recent years, Goldman, which is now a publicly traded company, has reached $1.8 trillion of assets under management and approximately $8 billion in profits. The company has multiple business lines and clients in different sectors and on both sides of public and private equity transactions.

Goldman's rapid expansion increased substantially the risk of serious conflicts of interest, as overlapping

roles and business lines, divergent clients, and a drive for growth all intersected. In the modern history of Goldman Sachs, reasonable investors would have been particularly interested in whether Goldman had systems in place to properly manage the conflicts its business model inevitably (and profitably) produces.

On the heels of two rounds of outside investment, Goldman was poised for considerable growth in the 1990s and 2000s. *See, e.g.*, Nathaniel C. Nash, *Goldman's Japan Tie Is Cleared*, N.Y. Times, Nov. 20, 1986, https://www.nytimes.com/1986/11/20/business/goldman-s-japan-tie-is-cleared.html; Kurt Eichenwald, *Insurers Buy an Interest in Goldman*, N.Y. Times, Dec. 3, 1991, https://www.nytimes.com/1991/12/03/business/insurers-buy-an-interest-in-goldman.html; Floyd Norris, *A Goldman Stake for Hawaiians*, N.Y. Times, Apr. 28, 1992, https://www.nytimes.com/1992/04/28/business/a-goldman-stake-for-hawaiians.html.

Goldman began investing in the securities and other deals it was putting together and selling to its own clients. *See* Resp. Br. 6. As Goldman entered into new, sometimes overlapping lines of business, it raised growing concerns about the firm's potentially serious conflicts. *See* Stephanie Strom, *In Some Cases, Goldman Sachs Is Pitted Against Its Own Clients*, N.Y. Times, Sept. 22, 1995, https://www.nytimes.com/1995/09/22/business/in-some-cases-goldman-sachs-is-pitted-against-its-own-clients.html. Sometimes, Goldman executives candidly acknowledged that potential conflicts of interest loomed large. Goldman's Vice Chairman, Hank Paulson, once explained:

> "In order to realize our strategic objective of creating a unique blend of client and proprietary businesses," he said, "we must develop a sophisticated management approach for

> 'relationship' conflicts as well as legal conflicts." . . . . Goldman needed "to do a much better job of managing conflicts" internally and in how "we articulate our business principles, policies and procedures."

William D. Cohan, *Money and Power: How Goldman Sachs Came to Rule the World* 377 (2012) (hereinafter "Cohan"). Paulson suggested that increasing potential problems with conflicts were due, *inter alia*, to "the firm's 'growing principal investing business,' [and] its 'growing market share and increasing global reach,'" *id.* These problems "stemmed, too, from 'our own inability to understand, articulate and manage these issues as well as we should.'" *Id.* Goldman owed its clients "full disclosure" about conflicts, "100% dedication to achieving their interest," and "professional execution." *Id.* But one thing "we don't owe them," Paulson concluded, was the "pledge to never work with anyone else who may have a competing economic interest." *Id.*

In 2005, Goldman's leaders, Hank Paulson and Lloyd Blankfein, again emphasized the importance of conflicts management in an annual letter to shareholders: "How we identify, disclose and manage real and apparent conflicts will be critical to the long-term success of our business. . . . [I]t is naïve to think we can operate without conflicts. They are embedded in our role as a valued intermediary—between providers and users of capital and those who want to shed risk versus those who are willing to assume it." Cohan at 440-41.

The risk of conflicts became particularly acute in the lead up to the 2008 crisis – Goldman assured the market that it was taking appropriate steps to responsibly manage those risks.

Much of the story of the housing bubble, global financial crisis, and egregious conduct that followed are now familiar to the general public, including the frenzied creation of exotic securities for subprime mortgages and the scourge of robo-signing. *See, e.g.,* NPR Staff, *Goldman Agrees to Halt Mortgage Robo-Signing*, NPR, Sept. 1, 2011, https://www.npr.org/2011/09/01/140121091/goldman-agrees-to-halt-mortgage-robo-signing. But lesser-known is the role that Goldman Sachs' conflicts-of-interest played in the lead up to the crisis.

Goldman apparently began this period by simply underwriting and trading mortgage-backed securities. After the firm's successful IPO in 1999, Goldman had significantly more of its own capital to trade with, *see* Cohan at 475, including in the immensely profitable mortgage markets. At first, Goldman was deeply involved in making markets and promoting various collateralized debt obligations, some of them increasingly esoteric and complex. Then, in partnership with fifteen other investment banks, Goldman in January 2006 launched the "ABX" index – composed of securities backed by home loans issued to borrowers with weak credit – and which, for the first time, allowed investors to speculate on the performance of the subprime mortgage market. *Id.* at 478.

But things evidently changed after a fateful meeting between Goldman and a prominent hedge fund manager, John Paulson (no relation to Hank Paulson). Paulson was one of the first to start trading the ABX index aggressively, largely through Deutsche Bank – but less than a few months later he had requested Goldman's help to trade the index as well. *See* Cohan at 488-89.

At first, Goldman agreed to execute subprime trades for Paulson, who believed subprime mortgage-backed securities were going to fail and wanted to aggressively short the market. But as the year progressed, Goldman's curiosity grew and it requested a meeting with Paulson about his trading strategy – soon turning Paulson from a Goldman client to more of a competitor. By the end of the year, Goldman was working to unload its long mortgage positions as quickly as possible; by January 2007 Goldman had flipped its risk profile and become significantly short on the mortgage market. *See* Cohan at 490-507.

Around the same time, Paulson asked Goldman to create, for a $15 million fee, a $2 billion synthetic collateralized debt obligation – later called ABACUS 2007-AC1 – that would allow him to make another massive "short" position on mortgage securities against traders going "long" on the other side. The firm worked with Paulson (the "sponsor") and ACA Management LLC, a bond portfolio agent, to identify a list of residential mortgage-backed securities to include in the index; in February 2007 they finalized the list of the ninety bonds that would make up the ABACUS portfolio. *See* Cohan at 509-17.

The very same day it finalized the ABACUS reference list, Goldman prepared a sixty-five-page PowerPoint presentation to market ABACUS to investors who might be willing to take the "long" side against Paulson's short. *See* Cohan at 517. Those marketing materials contained nearly thirty pages about ACA's expertise and selection process – stating that the bonds had been "Selected by ACA Management, LLC" – while making "no mention of Paulson, its economic interests in the transaction, or its role in selecting the reference portfolio." *SEC v. Goldman Sachs & Co. and Fabrice Tourre*, No. 10 Civ.

3229 (S.D.N.Y. filed Apr. 16, 2010) at para. 38, https://www.sec.gov/litigation/complaints/2010/comp-pr2010-59.pdf. Instead, "[i]nvestors were assured that the party selecting the portfolio had an 'alignment of economic interest' with investors." *Id*. Given Paulson's role in sponsoring the instrument for the purposes of going short – and as Goldman joined him directionally in that bet – these statements demonstrated Goldman's clear and inherent conflicts of interest in these sales. ACA later sued Goldman over ABACUS, claiming it was misled into believing Paulson was taking a long position in the portfolio; the case ultimately settled in 2016. *See* Karen Freifeld, *Goldman Sachs, Paulson settle fraud lawsuit over Abacus*, Reuters, Nov. 3, 2016, https://www.reuters.com/article/us-goldman-sachs-abacus-lawsuit/goldman-sachs-paulson-settle-fraud-lawsuit-over-abacus-idUSKBN12Y2W4.

Goldman elected to repeat the same failures to disclose material conflicts in other transactions. For example, in fall 2006 Goldman sold the Hudson Mezzanine Funding 2006-1 CDO, stating in marketing materials that "Goldman Sachs has aligned incentives with the Hudson program by investing in a portion of equity" – while at the same time taking out a sole, $2 billion investment on the short side of the deal, betting the security would collapse. When it collapsed, Goldman earned $1 billion. *See* Cohan at 599.

As a result, in 2007, Goldman continued to underwrite and sell billions of dollars of mortgage-related securities at the same time it internally was working to get net short – in other words, Goldman was "betting against the mortgage market as principal at the same time as the firm continued to underwrite mortgage securities as agent." Cohan at 529.

Goldman made various contemporaneous statements to the SEC and to its shareholders reassuring them that conflicts had been disclosed and managed. Goldman said it had "extensive procedures and controls that are designed to identify and address conflicts of interest." JA29. Goldman represented that "[o]ur clients' interests always come first." JA29, 31. Goldman continued to acknowledge that without proper procedures in place, this would be a serious problem. JA27 ("[c]onflicts of interest are increasing and a failure to appropriately identify and deal with conflicts of interest could adversely affect our businesses."). *See also* JA826, 836, 858 (Goldman's stock traded a "premium" compared to its competitors due to conflicts management).

By the spring of 2007, the entire subprime mortgage market was beginning to unravel. In June 2007, that moment came, when two Bear Stearns hedge funds were forced to revise their performance estimates due to mortgage losses, and eventually liquidated in July 2007. *See* Cohan at 555-56. That lit a fuse resulting in the March 2008 collapse of Bear Stearns and its fire sale to JPMorgan Chase, but only after the U.S. government agreed to buy $29 billion of Bear Stearns' most toxic assets. *Id*. *See also generally* William D. Cohan, *House of Cards: A Tale of Hubris and Wretched Excess on Wall Street* (2009).

The rest is history: a range of banks and funds experienced contagious loses in mortgage-backed securities, prompting massive write-downs, government bailouts, *see* Cohan at 559-60, and a calamitous crisis that could have caused a second Great Depression. Millions of Americans lost and were evicted from their homes and millions more lost their jobs as the economy shrank (a lifetime present-value loss of about $70,000 in income for every American,

according to the Federal Reserve Bank of San Francisco). *See* Federal Reserve Bank of San Francisco, *The Financial Crisis at 10: Will We Ever Recover?* (Aug. 13, 2018), https://www.frbsf.org/economic-research/publications/economic-letter/2018/august/financial-crisis-at-10-years-will-we-ever-recover/; Federal Reserve Bank of Chicago, *Have Borrowers Recovered from Foreclosures During the Great Recession* (2016), https://www.chicagofed.org/publications/chicago-fed-letter/2016/370; Better Markets, *The Cost of the Crisis: $20 Trillion and Counting* (July 2015), https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis.pdf.

Throughout all this turmoil and in large part due to its undisclosed net short position against the same mortgage securities it was selling, Goldman was hugely profitable: in the third quarter of 2007 its $12.3 billion revenue was its second-highest quarter of revenue ever. Its gains from its "short" far more than offset its losses in the rest of its mortgage business. Cohan at 567-594. As a result, its CEO received approximately $100 million in pay and stock for 2007. *See* Jonathan Stempel, *Goldman Sachs CEO gets $100 mln in pay, stock*, Reuters, Mar. 7, 2008, https://www.reuters.com/article/us-goldmansachs-compensation/goldman-sachs-ceo-gets-100-mln-in-pay-stock-idUSN0732738820080307.

Even as it brought in record profits and its executives pocketed historically high bonuses, the firm's conduct in the run-up to this crisis remained a huge risk factor for its own valuation, because many of these accounts of its actions had not yet been made public. When they were revealed, Goldman's shareholders and clients, like the Arkansas Teacher Retirement System, West Virginia Investment

Management Board, and Plumbers and Pipefitters Pension Group, experienced massive losses. *See* Resp. Br. at 9-10. Ultimately, the SEC's $550 million settlement with Goldman over its ABACUS sales was the agency's largest settlement with a financial firm in its history to date. *See* SEC, *Goldman Sachs to Pay Record $550 Million to Settle SEC Charges Related to Subprime Mortgage CDO* (July 15, 2010).

* * *

What should not be lost in the legal nuances of this case is the historical reality that how firms handle conflicts of interest matters a great deal. Indeed, a firm's approach to these powerful influences has proven legally material to shareholders and clients time and time again. How conflicts were handled at Goldman Sachs has proven especially consequential.

Goldman has at various times acknowledged that conflicts are both a serious problem and integral to its multi-pronged business strategy. While the banking sector may not be immune from all conflicts, particularly after the repeal of Glass-Steagall, it can undertake prophylactic measures, including robust disclosures, firewalls, separate teams, clear policies, and careful procedures. And to build a true culture of compliance, all such measures must be paired with robust internal supervision and an enforcement mechanism that imposes swift and meaningful consequences for violations of a firm's compliance policies.

If that culture of compliance is to become a reality, it must adhere to first principles: at a bare minimum, when major financial institutions make

representations to their shareholders about the existence or handling of conflicts, those statements must not be false or misleading. Especially in light of its history, Goldman's assurances to shareholders, spanning years, that it had a sophisticated system in place to manage conflicts made those statements even *more* meaningful and material. *Amicus* urges the Court to consider the broader historical context and allow this case to proceed on the merits.

CONCLUSION

For the foregoing reasons, this Court should affirm.

Respectfully submitted,

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