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.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

JOINT APPENDIX
(VOLUME 1; PAGES 1-400)

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PETITION FOR A WRIT OF CERTIORARI FILED: AUGUST 21, 2020
CERTIORARI GRANTED: DECEMBER 11, 2020

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Appendix A:	Court of appeals opinion, April 7, 2020
Appendix B:	District court opinion, August 14, 2018
Appendix C:	Court of appeals opinion, January 12, 2018
Appendix D:	District court opinion, September 24, 2015
Appendix E:	Court of appeals order denying rehearing, June 15, 2020

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 18-3667

ARKANSAS TEACHER RETIREMENT SYSTEM,

v.

GOLDMAN SACHS GROUP, INC.

RELEVANT DOCKET ENTRIES

DATE	NO.	PROCEEDINGS
12/11/2018	1	NOTICE OF CIVIL APPEAL, with district court docket, on behalf of Appellant Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc. and David A. Viniar, FILED. [2453066] [18-3667] [Entered: 12/11/2018 03:28 PM]
		* * *
02/15/2019	62	BRIEF & SPECIAL APPENDIX, on behalf of Appellant Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc. and David A. Viniar, FILED. Service date 02/15/2019 by CM/ECF. [2497793] [18-3667] [Entered: 02/15/2019 11:25 AM]
		* * *

DATE	NO.	PROCEEDINGS
04/19/2019	187	BRIEF, on behalf of Appellee Arkansas Teachers Retirement System, Plumbers and Pipefitters Pension Group and West Virginia Investment Management Board, FILED. Service date 04/19/2019 by CM/ECF. [2544138] [18-3667] [Entered: 04/19/2019 02:07 PM]
		* * *
05/03/2019	222	REPLY BRIEF, on behalf of Appellant Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc. and David A. Viniar, FILED. Service date 05/03/2019 by CM/ECF. [2555456] [18-3667] [Entered: 05/03/2019 02:45 PM]
		* * *
06/26/2019	232	CASE, before RCW, DC, RJS, HEARD. [2595132] [18-3667] [Entered: 06/26/2019 12:08 PM]
04/07/2020	233	OPINION, afirming the judgment of the district court and remanding for further proceedings consistent with this opinion, by RCW, DC, RJS (dissenting), FILED.[2815158] [18-3667] [Entered: 04/07/2020 08:46 AM]
04/07/2020	235	OPINION, Dissenting, by RJS, FILED. [2815163] [18-3667] [Entered: 04/07/2020 08:49 AM]
		* * *

DATE	NO.	PROCEEDINGS
04/07/2020	241	JUDGMENT, FILED. [2815368] [18-3667] [Entered: 04/07/2020 11:42 AM]
		* * *
05/12/2020	246	PETITION FOR REHEARING/ REHEARING EN BANC, on behalf of Appellant Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc. and David A. Viniar, FILED. Service date 05/12/2020 by CM/ECF. [2838130] [18-3667] [Entered: 05/12/2020 08:55 PM]
		* * *
06/15/2020	277	ORDER, petition for panel rehearing, or, in the alternative, for rehearing en banc, denied, FILED. [2861522] [18-3667] [Entered: 06/15/2020 09:26 AM]
		* * *
08/21/2020	290	LETTER, on behalf of Appellants Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc. and David A. Viniar, pursuant to Federal Rule of Appellate Procedure 41(d)(2)(B)(ii) to provide the Court with notice that Defendants-Appellants have today filed a petition for a writ of certiorari with the U.S. Supreme Court, RECEIVED. Service date 08/21/2020 by CM/ECF. [2914115] [18-3667]—

DATE	NO.	PROCEEDINGS
		[Edited 08/21/2020 by YL] [Entered: 08/21/2020 02:39 PM]
		* * *
08/26/2020	293	U.S. SUPREME COURT NOTICE of writ of certiorari filing, dated 08/25/2020, U.S. Supreme Court docket # 20-222, RECEIVED. [2917557] [18-3667] [Entered: 08/27/2020 07:46 AM]
		* * *

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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No. 16-250

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PENSION FUNDS,

v.

ARKANSAS TEACHERS RETIREMENT SYSTEM.

———

RELEVANT DOCKET ENTRIES

DATE	NO.	PROCEEDINGS
01/26/2016	1	NOTICE OF CIVIL APPEAL, with district court docket, on behalf of Appellant Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc. and David A. Viniar, FILED. [1691978] [16-250] [Entered: 01/26/2016 04:22 PM]

* * *

DATE	NO.	PROCEEDINGS
04/27/2016	46	BRIEF & SPECIAL APPENDIX, on behalf of Appellant Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc. and David A. Viniar, FILED. Service date 04/27/2016 by CM/ECF. [1759194] [16-250] [Entered: 04/27/2016 09:39 AM]

* * *

DATE	NO.	PROCEEDINGS
08/19/2016	129	BRIEF, on behalf of Appellee Arkansas Teachers Retirement System, Plumbers and Pipefitters Pension Group and West Virginia Investment Management Board, FILED. Service date 08/19/2016 by CM/ECF. [1845267] [16-250] [Entered: 08/19/2016 02:37 PM]
		* * *
09/19/2016	172	REPLY BRIEF, on behalf of Appellant Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc. and David A. Viniar, FILED. Service date 09/19/2016 by CM/ECF. [1865992] [16-250] [Entered: 09/19/2016 04:10 PM]
		* * *
03/15/2017	215	CASE, before JAC, RCW, C.JJ., SESSIONS, D.J., HEARD. [1989015] [16-250] [Entered: 03/15/2017 11:20 AM]
		* * *
01/12/2018	224	OPINION, the district court's order is vacated and remanded for further proceedings, by JAC, RCW, W. SESSIONS, FILED.[2212524] [16-250] [Entered: 01/12/2018 09:42 AM]
		* * *

DATE	NO.	PROCEEDINGS
01/12/2018	230	JUDGMENT, FILED.[2213065] [16-250] [Entered: 01/12/2018 02:19 PM]

* * *

U.S. DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

No. 1:10-cv-03461-PAC

PENSION FUNDS,

v.

ARKANSAS TEACHERS RETIREMENT SYSTEM.

RELEVANT DOCKET ENTRIES

DATE	NO.	PROCEEDINGS
04/26/2010	1	COMPLAINT against Goldman Sachs Group, Inc., Lloyd C. Blankfein, David A. Viniar, Gary D. Cohn. (Filing Fee $ 350.00, Receipt Number 901612) Document filed by Ilene Richman. (ama) (Entered: 04/27/2010)
		* * *
07/25/2011	68	CONSOLIDATED CLASS ACTION AMENDED COMPLAINT amending 1 Complaint against Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc., David A. Viniar with JURY DEMAND.Document filed by Plumbers and Pipefitters Pension Group, West Virginia Investment Management Board, Arkansas Teachers Retirement

DATE	NO.	PROCEEDINGS
		System. Related document: 1 Complaint filed by Ilene Richman. ***This document relates to all actions.(mro) (sdi). (Entered: 07/26/2011)

* * *

DATE	NO.	PROCEEDINGS
10/06/2011	74	FIRST MOTION to Dismiss the Consolidated Complaint. Document filed by Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc., David A. Viniar.(Klapper, Richard) (Entered: 10/06/2011)
10/06/2011	75	MEMORANDUM OF LAW in Support re: 74 FIRST MOTION to Dismiss the Consolidated Complaint.. Document filed by Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc., David A. Viniar. (Klapper, Richard) (Entered: 10/06/2011)

* * *

DATE	NO.	PROCEEDINGS
11/14/2011	77	MEMORANDUM OF LAW in Opposition re: 74 FIRST MOTION to Dismiss the Consolidated Complaint.. Document filed by Arkansas Teachers Retirement System, Plumbers and Pipefitters Pension Group, West Virginia Investment Management Board. (Dubbs, Thomas) (Entered: 11/14/2011)

* * *

DATE	NO.	PROCEEDINGS
12/14/2011	81	REPLY MEMORANDUM OF LAW in Support re: 74 FIRST MOTION to Dismiss the Consolidated Complaint.. Document filed by Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc., David A. Viniar. (Klapper, Richard) (Entered: 12/14/2011)
		* * *
05/21/2012		Minute Entry for proceedings held before Judge Paul A. Crotty: Oral Argument held on 5/21/2012 re: 74 FIRST MOTION to Dismiss the Consolidated Complaint. filed by Gary D. Cohn, David A. Viniar, Lloyd C. Blankfein, Goldman Sachs Group, Inc.. (Court Reporter Alena Lynch) (mov) (Entered:05/22/2012)
		* * *
06/21/2012	85	OPINION & ORDER: #101981 In conclusion, Defendants' motion to dismiss is GRANTED with respect to Plaintiffs claim relating to Defendants failure to disclose their receipt of Wells Notices, and DENIED in all other respects. The Clerk of Court is directed to terminate this motion. SO ORDERED. (Signed by Judge Paul A. Crotty on June 21, 2012) (mov) Modified on 7/2/2012 (jab). (Entered: 06/21/2012)

DATE	NO.	PROCEEDINGS
		* * *
08/20/2012	87	ANSWER to 68 Amended Complaint,. Document filed by Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc., David A. Viniar.(Klapper, Richard) (Entered: 08/20/2012)
		* * *
05/30/2014	116	MOTION for Reconsideration of the Court's June 21, 2012 Ruling on Defendants' Motion to Dismiss. Document filed by Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc., David A. Viniar.(Klapper, Richard) (Entered: 05/30/2014)
		* * *
06/06/2014	119	MEMORANDUM OF LAW in Opposition re: 116 MOTION for Reconsideration of the Court's June 21, 2012 Ruling on Defendants' Motion to Dismiss. . Document filed by Arkansas Teachers Retirement System, Plumbers and Pipefitters Pension Group, West Virginia Investment Management Board. (Dubbs, Thomas) (Entered: 06/06/2014)
06/13/2014	120	REPLY MEMORANDUM OF LAW in Support re: 116 MOTION for Reconsideration of the Court's June 21, 2012 Ruling on Defendants'

DATE	NO.	PROCEEDINGS
		Motion to Dismiss. . Document filed by Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc., David A. Viniar. (Klapper, Richard) (Entered: 06/13/2014)
		* * *
06/23/2014	122	ORDER denying 116 Motion for Reconsideration (Signed by Judge Paul A. Crotty on 06/23/2014) (mov) (Entered: 06/23/2014)
		* * *
01/30/2015	135	MOTION to Certify Class . Document filed by Arkansas Teachers Retirement System, Plumbers and Pipefitters Pension Group, West Virginia Investment Management Board. (Burkholz, Spencer) (Entered: 01/30/2015)
01/30/2015	136	MEMORANDUM OF LAW in Support re: 135 MOTION to Certify Class . . Document filed by Arkansas Teachers Retirement System, Plumbers andPipefitters Pension Group, West Virginia Investment Management Board. (Attachments: # 1 Exhibit A - Robbins Geller Firm Resume, # 2 Exhibit B - Labaton Sucharow Firm Resume)(Burkholz, Spencer) (Entered: 01/30/2015)
		* * *

DATE	NO.	PROCEEDINGS
04/06/2015	142	MEMORANDUM OF LAW in Opposition re: 135 MOTION to Certify Class . . Document filed by Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc., David A. Viniar. (Attachments: # 1 Appendix A)(Klapper, Richard) (Entered: 04/06/2015)
		* * *
05/15/2015	153	REPLY MEMORANDUM OF LAW in Support re: 135 MOTION to Certify Class . . Document filed by Arkansas Teachers Retirement System, Plumbers and Pipefitters Pension Group, West Virginia Investment Management Board. (Burkholz, Spencer) (Entered: 05/15/2015)
		* * *
05/28/2015	156	LETTER addressed to Judge Paul A. Crotty from Richard H. Klapper dated May 28, 2015 re: Request for Evidentiary Hearing or Pre-Motion Conference. Document filed by Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc., David A. Viniar.(Klapper, Richard) (Entered: 05/28/2015)
06/02/2015	157	LETTER addressed to Judge Paul A. Crotty from Thomas A, Dubbs dated 6/2/2015 re: Response and in opposition to Defendants' letter of

DATE	NO.	PROCEEDINGS
		5/28/2015 requesting oral argument and two-day evidentiary hearing on Plaintiffs' motion for class certification. Document filed by Arkansas Teachers Retirement System, Plumbers and Pipefitters Pension Group, West Virginia Investment Management Board.(Dubbs, Thomas) (Entered: 06/02/2015)
06/08/2015	158	ORDER: The Court is in receipt of the parties' letters of May 28, 2015 and June 2, 2015. Defendants have requested oral argument and a two-day evidentiary hearing on Plaintiffs' motion for class certification. Defendants have also requested leave to submit a 10-page surreply brief, responsive expert declarations, and "relevant portions of their experts' testimony that Plaintiffs elected not to submit." Plaintiffs oppose the request for an evidentiary hearing and the request to submit supplemental papers. Defendants' requests for an evidentiary hearing and oral argument are denied. Defendants' request for leave to file surreply papers in granted in part. Defendants may submit a 5-page responsive brief, a 10-page responsive expert declaration, and any testimony necessary to ensure that the record is complete. (Signed by Judge Paul A.

DATE	NO.	PROCEEDINGS
		Crotty on 6/8/2015) (lmb) (Entered: 06/08/2015)
		* * *
06/23/2015	160	REPLY MEMORANDUM OF LAW in Opposition re: 135 MOTION to Certify Class . . Document filed by Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc., David A. Viniar. (Klapper, Richard) (Entered: 06/23/2015)
		* * *
09/24/2015	163	OPINION & ORDER re: 135 MOTION to Certify Class . filed by Arkansas Teachers Retirement System, West Virginia Investment Management Board, Plumbers and Pipefitters Pension Group. For the foregoing reasons, the Court grants Plaintiffs' motion for class certification. The Court certifies a class of: "All persons or entities who, between February 5, 2007 and June 10, 2010, purchased or otherwise acquired the common stock of The Goldman Sachs Group, Inc . . . . and were damaged thereby." Labaton Sucharow LLP and Robbins Geller Rudman & Dowd LLP are approved as Class Counsel, and Lead Plaintiffs Arkansas Teacher Retirement System, Plumbers and Pipefitters National Pension Fund, and

DATE	NO.	PROCEEDINGS
		West Virginia Investment Management Board are appointed Class Representatives. The Clerk of the Court is directed to close out the pending motion at Docket 135. (As further set forth in this Order) (Signed by Judge Paul A. Crotty on 9/24/2015) (lmb) (Entered: 09/24/2015)

* * *

DATE	NO.	PROCEEDINGS
01/28/2016	175	TRUE COPY ORDER of USCA USCA Case Number 15-3179. Petitioners move, pursuant to Federal Rule of Civil Procedure 23(f), for leave to appeal the district court's order granting Respondents motion for class certification. Petitioners also move for leave to file a reply in support of their motion. Further, non-parties the Securities Industry and Financial Markets Association ("SIFMA"), the Chamber of Commerce of the United States ("the Chamber"), and a group of former Securities and Exchange Commission ("SEC") officials and law professors move to file briefs as amicus curiae in support of Petitioners' motion. Upon due consideration, it is hereby ORDERED that: (1) Petitioners' motion to file a reply is GRANTED; (2) the motions of the Chamber, SIFMA, and the

DATE	NO.	PROCEEDINGS
		group of former SEC officials and law professors to file amicus briefs are GRANTED; and (3) the petition for leave to appeal is GRANTED. Catherine O'Hagan Wolfe, Clerk USCA for the Second Circuit. Certified: 01/28/2016. [New Appeal Case No. 16-250]. (nd) (Entered: 01/28/2016)
		* * *
02/02/2018	183	MANDATE of USCA (Certified Copy) USCA Case Number 16-0250. The appeal in the above captioned case from an order of the United States District Court for the Southern District of New York was argued on the district court's record and the parties briefs. Upon consideration thereof, IT IS HEREBY ORDERED, ADJUDGED and DECREED that the order of the district court is VACATED and the case is REMANDED for further proceedings consistent with this Court's opinion. Catherine O'Hagan Wolfe, Clerk USCA for the Second Circuit. Issued As Mandate: 02/02/2018. (Attachments: # 1 Opinion) (nd) (Entered: 02/02/2018)
		* * *
03/15/2018	189	ORDER, The Court orders the following schedule: Opening Brief:

DATE	NO.	PROCEEDINGS
		April 13, 2018, Reply Brief: April 27, 2018, Oral Argument: May 22, 2018 at 10:00 AM. Parties are ordered to simultaneously file the opening briefs and the reply briefs by the respective deadlines. The opening briefs shall be limited to 25 pages; the reply briefs shall be limited to 15 pages. The oral argument shall be limited to 3 hours, 1.5 hours per side. The Court reserves the right to hold an evidentiary hearing should the parties' briefs and oral argument demonstrate its necessity or desirability. The Court hereby lifts the previously imposed stay of this action. So Ordered. (Brief due by 4/13/2018., Replies due by 4/27/2018., Oral Argument set for 5/22/2018 at 10:00 AM before Judge Paul A. Crotty.) (Signed by Judge Paul A. Crotty on 3/15/18) (yv) Modified on 3/15/2018 (yv). (Main Document 189 replaced on 3/15/2018) (yv). (Entered: 03/15/2018)
		* * *
04/13/2018	192	SUPPLEMENTAL MEMORANDUM OF LAW in Opposition re: 135 MOTION to Certify Class . . Document filed by Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc., David A. Viniar.

DATE	NO.	PROCEEDINGS
		(Giuffra, Robert) (Entered: 04/13/2018)
		* * *
04/13/2018	196	MEMORANDUM OF LAW in Support re: 135 MOTION to Certify Class . (Lead Plaintiffs' Memorandum of Law in Further Support of Class Certification). Document filed by Arkansas Teachers Retirement System, Plumbers and Pipefitters Pension Group, West Virginia Investment Management Board. (Dubbs, Thomas) (Entered: 04/13/2018)
		* * *
04/27/2018	198	SUPPLEMENTAL REPLY MEMORANDUM OF LAW in Opposition re: 135 MOTION to Certify Class . . Document filed by Lloyd C. Blankfein, Gary D. Cohn, Goldman Sachs Group, Inc., David A. Viniar. (Giuffra, Robert) (Entered: 04/27/2018)
04/27/2018	199	SUPPLEMENTAL REPLY MEMORANDUM OF LAW in Support re: 135 MOTION to Certify Class . (Lead Plaintiffs' Supplemental Reply Memorandum of Law in Further Support of Class Certification). Document filed by Arkansas Teachers Retirement System, Plumbers and Pipefitters Pension

DATE	NO.	PROCEEDINGS
		Group, West Virginia Investment Management Board. (Dubbs, Thomas) (Entered: 04/27/2018)
		* * *
07/25/2018		Minute Entry for proceedings held before Judge Paul A. Crotty: Evidentiary Hearing held on 7/25/2018. Lawrence Sucharow, Thomas Dubbs, Spencer Burkholz, Jonah Goldstein, James Johnson, and Robert Henssler, Jr. appeared for the Lead Plaintiff. Robert Giuffra, Jr., Richard Klapper, David Rein, Benjamin Walker, Jacob Cohen, and Julia Malkina appeared for the Defendants. Argument was heard from both sides. Oral Argument will go forward tomorrow, July 26, 2018 at 9:30 AM. See transcript for details. (Court Reporter Pamela Utter, Sam Mauro, Kristen Carannante) (dgo) (Entered: 07/25/2018)
		* * *
08/14/2018	217	OPINION AND ORDER re: (135 in 1:10-cv-03461-PAC) MOTION to Certify Class . filed by Arkansas Teachers Retirement System, West Virginia Investment Management Board, Plumbers and Pipefitters Pension Group. For the reasons set forth above, the Court concludes

DATE	NO.	PROCEEDINGS
		that Defendants have failed to meet their burden of proof: the Basic presumption is not rebutted and the motion for class certification is granted. The Clerk of Court is directed to terminate the pending motion at ECF 135. (Signed by Judge Paul A. Crotty on 8/14/2018) Filed In Associated Cases: 1:10-cv-03461-PAC et al.(rro) (Entered: 08/14/2018)

* * *

12/11/2018	232	ORDER of USCA (Certified Copy) USCA Case Number 18-2557. Petitioners request, pursuant to Federal Rule of Civil Procedure 23(f), leave to appeal the district court's order granting Respondents' motion for class certification. Petitioners also move for permission to file a reply brief. And three amici curiae move for leave to file amicus briefs. Upon due consideration, it is hereby ORDERED that the petition for leave to appeal is GRANTED. The motion for leave to file a reply brief is DENIED. The motions of amici curiae for permission to file amicus briefs are GRANTED. The Petitioners are directed to file a scheduling notification within 14 days of the date of entry of this order pursuant to Second Circuit Local Rule 31.2.

DATE	NO.	PROCEEDINGS
		Catherine O'Hagan Wolfe, Clerk USCA for the Second Circuit. Certified: 12/11/2018. (nd) (Entered: 12/11/2018)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended November 30, 2007

Commission File Number: 001-14965

The Goldman Sachs Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**13-4019460** **(I.R.S. Employer Identification No.)**
85 Broad Street **New York, N.Y.** **(Address of principal executive offices)**	**10004** **(Zip Code)**

(212) 902-1000
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class:	Name of each exchange on which registered:
Common stock, par value $.01 per share, and attached Shareholder Protection Rights	New York Stock Exchange
Depositary Shares, Each Representing 1/1,000th Interest in a Share of Floating Rate Non-Cumulative Preferred Stock, Series A	New York Stock Exchange
Depositary Shares, Each Representing 1/1,000th Interest in a Share of 6.20% Non-Cumulative Preferred Stock, Series B	New York Stock Exchange
Depositary Shares, Each Representing 1/1,000th Interest in a Share of Floating Rate Non-Cumulative Preferred Stock, Series C	New York Stock Exchange
Depositary Shares, Each Representing 1/1,000th Interest in a Share of Floating Rate Non-	New York Stock Exchange

Cumulative Preferred Stock, Series D	
5.793% Fixed-to-Floating Rate Normal Automatic Preferred Enhanced Capital Securities of Goldman Sachs Capital II (and Registrant's guarantee with respect thereto)	**New York Stock Exchange**
Floating Rate Normal Automatic Preferred Enhanced Capital Securities of Goldman Sachs Capital III (and Registrant's guarantee with respect thereto)	**New York Stock Exchange**
Medium-Term Notes, Series B, Index-Linked Notes due February 2013; Index-Linked Notes due April 2013; Index-Linked Notes due May 2013; Index-Linked Notes due 2010; and Index-Linked Notes due 2011	**American Stock Exchange**
Medium-Term Notes, Series B, 7.35% Notes due 2009; 7.80% Notes due 2010; Floating Rate Notes due 2008; and Floating Rate Notes due 2011	**New York Stock Exchange**

Medium-Term Notes, Series A, Index-Linked Notes due 2037 of GS Finance Corp. (and Registrant's guarantee with respect thereto)	**NYSE Arca**
Medium-Term Notes, Series B, Index-Linked Notes due 2037	**NYSE Arca**

Securities registered pursuant to Section 12(g) of the Act: None

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Annual Report on Form 10-K or any amendment to the Annual Report on Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒
Accelerated filer ☐
Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

As of May 25, 2007, the aggregate market value of the common stock of the registrant held by non-affiliates of the registrant was approximately $89.1 billion.

As of January 18, 2008, there were 395,907,302 shares of the registrant's common stock outstanding.

Documents incorporated by reference: Portions of The Goldman Sachs Group, Inc.'s Proxy Statement for its 2008 Annual Meeting of Shareholders to be held on April 10, 2008 are incorporated by reference in the Annual Report on Form 10-K in response to Part III, Items 10, 11, 12, 13 and 14.

* * *

Conflicts of interest are increasing and a failure to appropriately identify and deal with conflicts of interest could adversely affect our businesses.

Our reputation is one of our most important assets. As we have expanded the scope of our businesses and our client base, we increasingly have to address potential conflicts of interest, including situations where our services to a particular client or our own proprietary investments or other interests conflict, or are perceived to conflict, with the interests of another client, as well as situations where one or more of our businesses have access to material non-public information that may not be shared with other businesses within the firm.

The SEC, the NYSE, FINRA, other federal and state regulators and regulators outside the United States, including in the United Kingdom and Japan, have announced their intention to increase their scrutiny of potential conflicts of interest, including through detailed examinations of specific transactions. There have been complaints filed against financial institutions, including Goldman Sachs, alleging the violation of antitrust laws arising from their joint participation in certain leveraged buyouts, referred to as "club deals," as discussed under "Legal Proceedings — Private Equity-Sponsored Acquisitions Litigation" in Part I, Item 3 of the Annual Report on Form 10-K. In addition, a number of class action complaints have also been filed in connection with certain specific "club deal" transactions which name the relevant "club deal" participants among the defendants, including Goldman Sachs affiliates in several cases, and generally allege that the transactions constitute a breach of fiduciary duty by the target company and that the "club" participants aided and abetted such breach. We cannot predict the outcome of the litigation to which we are a party, and we may become subject to further litigation or regulatory scrutiny in the future in this regard.

We have extensive procedures and controls that are designed to identify and address conflicts of interest, including those designed to prevent the improper sharing of information among our businesses. However, appropriately identifying and dealing with conflicts of interest is complex and difficult, and our reputation could be damaged and the willingness of clients to enter into transactions in which such a conflict might arise may be affected if we fail, or appear to fail, to identify and deal appropriately with conflicts of interest. In addition, potential or perceived conflicts could give rise to litigation or enforcement actions.

The Goldman Sachs Business Principles

1

Our clients' interests always come first. Our experience shows that if we serve our clients well, our own success will follow.

2

Our assets are our people, capital and reputation. If any of these is ever diminished, the last is the most difficult to restore. We are dedicated to complying fully with the letter and spirit of the laws, rules and ethical principles that govern us. Our continued success depends upon unswerving adherence to this standard.

3

Our goal is to provide superior returns to our shareholders. Profitability is critical to achieving superior returns, building our capital, and attracting and keeping our best people. Significant employee stock ownership aligns the interests of our employees and our shareholders.

4

We take great pride in the professional quality of our work. We have an uncompromising determination to achieve excellence in everything we undertake. Though we may be involved in a wide variety and heavy volume of activity, we would, if it came to a choice, rather be best than biggest.

5

We stress creativity and imagination in everything we do. While recognizing that the old way may still be the best way, we constantly strive to find a better solution to a client's problems. We pride ourselves on having pioneered many of the practices and techniques that have become standard in the industry.

6

We make an unusual effort to identify and recruit the very best person for every job. Although our activities are measured in billions of dollars, we select our people one by one. In a service business, we know that without the best people, we cannot be the best firm.

7

We offer our people the opportunity to move ahead more rapidly than is possible at most other places. Advancement depends on merit and we have yet to find the limits to the responsibility our best people are able to assume. For us to be successful, our men and women must reflect the diversity of the communities and cultures in which we operate. That means we must attract, retain and motivate people from many backgrounds and perspectives. Being diverse is not optional; it is what we must be.

8

We stress teamwork in everything we do. While individual creativity is always encouraged, we have found that team effort often produces the best results. We have no room for those who put their personal interests ahead of the interests of the firm and its clients.

9

The dedication of our people to the firm and the intense effort they give their jobs are greater than one finds in most other organizations. We think that this is an important part of our success.

10

We consider our size an asset that we try hard to preserve. We want to be big enough to undertake the largest project that any of our clients could contemplate, yet small enough to maintain the loyalty, the intimacy and the esprit de corps that we all treasure and that contribute greatly to our success.

11

We constantly strive to anticipate the rapidly changing needs of our clients and to develop new services to meet those needs. We know that the world of finance will not stand still and that complacency can lead to extinction.

12

We regularly receive confidential information as part of our normal client relationships. To breach a confidence or to use confidential information improperly or carelessly would be unthinkable.

13

Our business is highly competitive, and we aggressively seek to expand our client relationships. However, we must always be fair competitors and must never denigrate other firms.

14

Integrity and honesty are at the heart of our business. We expect our people to maintain high ethical standards in everything they do, both in their work for the firm and in their personal lives.

FINANCIAL TIMES

Markets & Investing

Wednesday December 5, 2007

John Plender Insight

Goldman's risk control offers right example of governance

Financial institutions are notorious for responding to market shocks in a herd. They are driven to this behaviour by complex but flawed risk-management models that assume little interaction between the individual institution and other players in the market. Yet in spite of this impulse to conformity, the risk-management performance of banks in this credit market turmoil is anything but herd-like. What is striking is the sheer variability of outcomes.

At one end of the spectrum Goldman Sachs sails sublimely on, churning out ever-improving earnings figures while offsetting losses on its exposure to the subprime market with vast profits on short positions in mortgages. At the other end, Merrill Lynch and Citigroup write off billions and shed their chief executive officers. How is this disparity to be explained?

Much of it is down to culture. Until recently, Goldman was a partnership, which is one of the best risk-control mechanisms invented. The culture of partnership, which entails a high degree of mutual surveillance in the common interest, still survives in spite of Goldman's status as a listed company. That is clear from remarks made at a Wharton finance conference in New York last month by Lloyd Blankfein, Goldman's chairman and chief executive.

Apart from the discipline of marking to market, he explained, the firm put great emphasis on ensuring that risk concerns were constantly communicated to higher levels of management, “getting more fingerprints” on potential problem risks and challenging the notion that a business group leader ought to make independent decisions on risks that affected the entire firm. There was intense accountability through a host of management committees that evaluated all aspects of risk.

Most importantly, Goldman ascribes as much status, prestige and pay to people engaged in control functions as to those running businesses. It constantly rotates human capital back and forth between risk control and business operations.

Compare and contrast with any large bank, where risk management too often degenerates into mere compliance. In such a culture, traders will always find ways around the rules. And if those in charge of the bank are rewarded with bonuses and other incentives where the award is not deferred for long enough, you have a roller-coaster cycle of escalating returns invariably followed by heavy losses.

The structure of boards is also relevant. In the US governance model, the chairman and CEO roles tend not to be split, while the boards are dominated by non-executives who too often lack expertise in risk. Over the recent credit cycle, these non-executive directors permitted a huge escalation of risk across the banking system. They also sanctioned pay deals for CEOs, complete with rewards for failure, that encouraged risk escalation.

Pete Hahn, a former Citigroup executive who is now a fellow at the Cass Business School in London, argues bank boards too often resemble retirement clubs. And he has a point. Apart from CEO Stan O'Neal, only three of the 12 directors of Merrill at the end of last year were under 60. Distinguished though Merrill's board was, it was hardly chock-a-block with expertise on banking and risk.

In contrast, Mr Blankfein is accompanied on the board by two other executive directors, together with Stephen Friedman, a former senior partner of the firm. So there is a core group on the board steeped in the disciplines of risk. And Goldman's managing directors include Gerald Corrigan, a former head of the Federal Reserve Bank of New York, who is regarded as the pre-eminent expert on financial plumbing.

It would be foolish to assume the firm will be necessarily immune from upsets in a deepening credit squeeze. It has had problems with its in-house hedge funds. But it does offer a marked contrast to the "big bank" model now under attack from shareholder activists such as Knight Vinke. Within a predominantly wholesale operation its activities are diverse. Yet they offer genuine synergies, albeit with potential conflicts of interest.

It is clear that bank governance badly needs a rethink. With its distinctive model, Goldman offers interesting food for thought.

John Plender is an FT columnist and chairman of Quintain

DOW JONES

BUSINESS NEWS

December 11, 2007

13 Reasons Bush's Bailout Won't Stop A Recession

By Paul B. Farrell

ARROYO GRANDE, Calif. (Dow Jones) – "What do you call an economist with a prediction? Wrong."

That was the headline of a Business Week column in late 1999, just months before the 2000 dot-com crash.

Yes, wrong: Conservative supply-siders, balanced-budget centrists and liberal Keynesian stimulators, too. All wrong! And the 2000 to 2002 recession proved it.

Unfortunately, everybody thinks they're an economist today, even politicians. But they're bad at it, too. So we need to update the headline to fit the mortgage bailout and other quick-fix solutions to America's problems.

First, the context: Fortune magazine recently put CEOs such as Citi's Prince and Merrill's O'Neill under the microscope: "What Were They Smoking?" The best-and-brightest lost $165 billion, but exited rich, with hundreds of millions.

Now we need to ask guys like Paulson, Bernanke and their Beltway buddies: "What are you guys still smoking?" Bailout? Freeze? Voluntary? They must be smoking hundred dollar bills from lobbyists because this government intervention scheme smells bad.

Why? Because all these solutions are being dreamed up by the same political and financial geniuses who got us into the problems in the first place. The same guys who failed to act before the economy spun out of control. Trusting those same guys makes absolutely no sense! They were clueless going in. They're clueless about the solutions. So, a new rule: "What do you call a politician with a prediction? Wrong!"

Though you may disagree with Dick Cheney, this time he's the only guy inside the Beltway who's got it right. Fortune says "the staunchly free-market Vice President can be expected to resist any impulse to soften the blow with government action." His position: "The markets work, and they are working."

But unfortunately, Bush, Paulson, Bernanke and the Democrats are out-voting Cheney. They're all pushing government programs predicted to slow the record number of home foreclosures and "ease the damage from the housing recession," as USAToday described the short-term goals.

What are they still smoking? Reminds me of Viking King Canute sitting on his throne at the shore commanding the tide to stop. Folks, tides and recessions come and go. And wishful-thinking, fairy-tale solutions won't stop the inevitable, any more than proclaiming this plan will "ease the damage of the recession," but it's "not a bailout, nor a silver bullet."

So let's step back and look at the facts objectively and rationally. Let's look at the 13 reasons why all the bailout fixes are just cosmetic PR that politicians and lobbyists spin for the masses, to gloss over Wall Street's greed and stupidity during the latest bull run-up, while pandering to voter naiveté, undermining America's long-term needs, and proving once again that our leaders cannot manage our nation effectively.

Here are 13 reasons:

1. No bailout for sock puppets. . . and not for junk mortgages

Remember all the shareholders who invested in Wall Street's last fiasco, those bizarre, no-earnings, dot-com schemes like Pets.com and its cute sock puppet? Nobody bailed them out after the 2000 crash that triggered a 30-month recession and wiped out $8 trillion in market-cap. This time Washington's just trying to salvage an out-of-control Wall Street.

2. U.S. dollar loses more credibility

Can it get worse? Yes, the dollar will sink lower. Martin Feldman, former chairman of Reagan's Council of Economic Advisers, recommends doing nothing in a Wall Street Journal OpEd piece: "Arbitrarily changing the terms of mortgages held by investors around the world would destroy the credibility of American private debt." But they're doing it anyway. They got greedy, sold junk. Now people don't trust us anymore.

3. Supply-side hypocrisy

It's almost funny. Supply-siders pretend to trust the free market to work out problems. Yet the elite of the conservative free-market supply-siders on Wall Street, at the Federal Reserve and (except for the Veep) in the White House, pushed for and got government intervention to minimize mortgage credit losses created by Wall Street's excessive greed.

4. PR stunt and photo-op

Washington knows this is just a PR photo-op pandering to Middle America's fears. But "it's too little, too late and too voluntary" says a New York Times editorial. "Only an estimated 250,000 borrowers, at best, will benefit" from the mortgage-rate freeze. "From mid-2007 to now, some 800,000 have entered foreclosure. From 2008 through mid-2010 . . . there will be an estimated 3.5 million loan defaults." Free market politicians know it won't work.

5. Undermines responsible mortgagees

Many worry the biggest losers may profit most, like speculators. Even junk mortgagees who are able to pay excessive reset rates may get no breaks. Moreover, the damage will spill-over to the tens of millions of responsible homeowners who are current on their mortgages. Plus, they will be indirectly penalized; for example, if they have to sell, they'll compete against mortgagees getting bailout benefits and tax breaks in a down market.

6. Taxpayer revolution coming

Wall Street got too greedy, made mega-billions. The average managing director made $2.52 million repackaging mortgages. Bubble pops. Housing collapses. Defaults. Foreclosures. Local revenues dropping. Federal, too. A Wall Street Journal editorial put it bluntly: "More than 95% of homeowners are making payments on time, and they believe it is unfair to pay more taxes to assist those who've been less responsible." Still, it's happening and they're angry. Expect a rebellion. This is Wall Street's problem, not the taxpayers.

7. Déjà vu Spitzer and Enron

New York Attorney General Andrew Cuomo has already subpoenaed Wall Street. Next: Congress, the SEC and other state regulators will demand answers, such as why was Goldman shorting the SIVs they were selling, many of which quickly went into default? What did they fail to disclose? Sounds like a massive conflict of interest with major liabilities. These hearings could drag on a long time, further undermining the international credibility of the dollar.

8. Washington was hiding the truth

As recently as August, U.S. Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke both proclaimed that our subprime/credit problems were "contained." Then, suddenly, they were a "contagion" enflaming recession fears. The truth: Both had the data long before August, and mislead us. One is a former chief of a leading Wall Street bank packaging the SIVs. The other is our Fed boss with a staff of thousands of economists and data-crunchers. They knew the truth many months ago, and did nothing.

9. Washington's priority? Wall Street

Remember, Paulson's first response in August was not to help the two million subprime mortgage holders. No, Paulson's first response was to create a $100 billion bailout fund to help his old Wall Street cronies keep all those junk mortgage credits off their balance sheets. More conflicts? You bet. Enough to make Chris Dodd, chairman of the Senate Banking Committee, threaten a formal investigation of Paulson.

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THE WALL STREET JOURNAL

Friday, December 14, 2007 – VOL. CCL NO. 140

How Goldman Won Big On Mortgage Meltdown

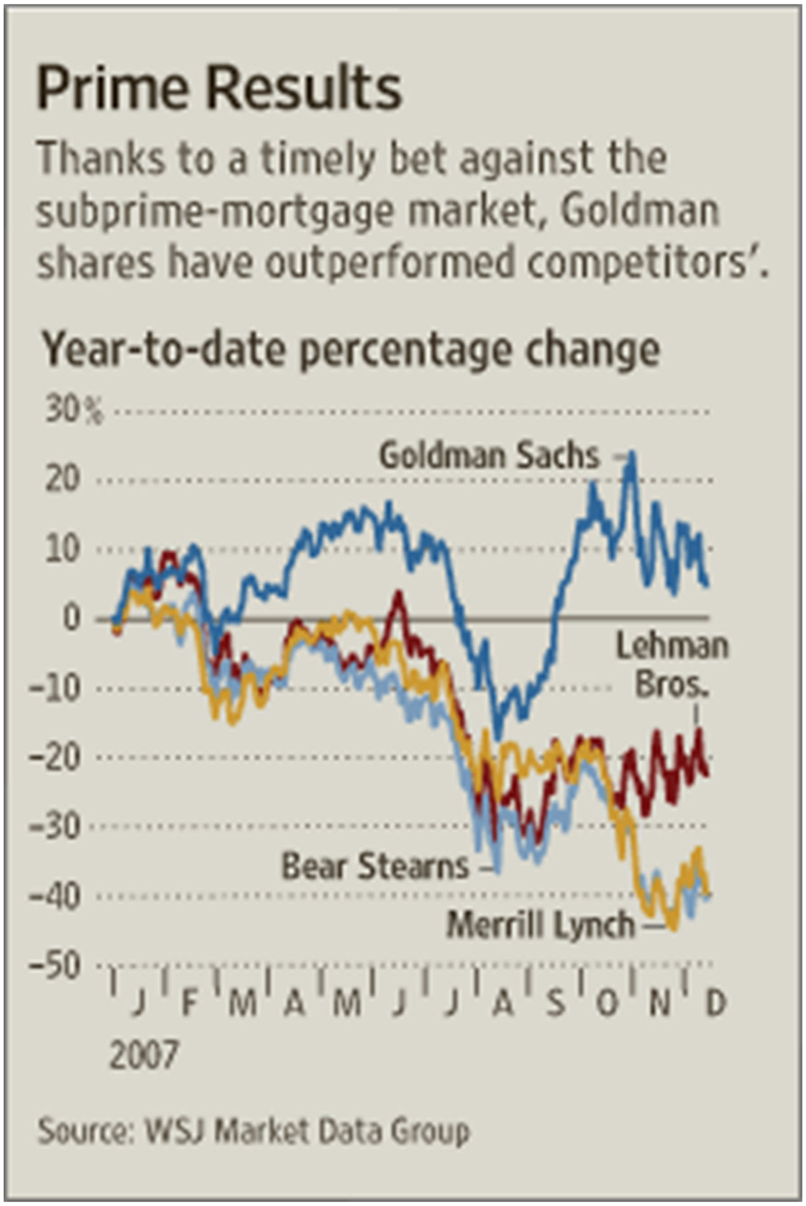
A Team's Bearish Bets Netted Firm Billions; A Nudge From the CFO

By Kate Kelly

The subprime-mortgage crisis has been a financial catastrophe for much of Wall Street. At Goldman Sachs Group Inc., thanks to a tiny group of traders, it has generated one of the biggest windfalls the securities industry has seen in years.

The group's big bet that securities backed by risky home loans would fall in value generated nearly $4 billion of profits during the year ended Nov. 30, according to people familiar with the firm's finances. Those gains erased $1.5 billion to $2 billion of mortgage-related losses elsewhere in the firm. On Tuesday, despite a terrible November and some of the worst market conditions in decades, analysts expect Goldman to report record net annual income of more than $11 billion.

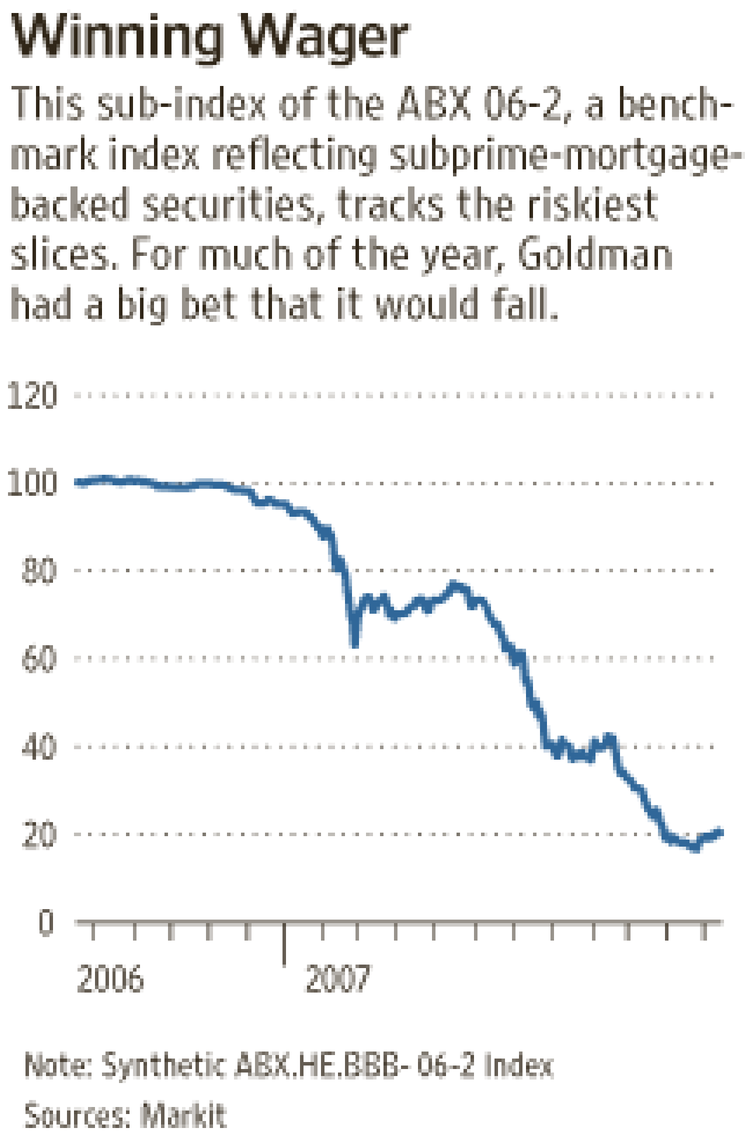
Goldman's trading home run was blasted from an obscure corner of the firm's mortgage department -- the structured-products trading group, which now numbers about 16 traders. Two of them, Michael Swenson, 40 years old, and Josh Birnbaum, 35, pushed Goldman to wager that the subprime market was heading for trouble. Their boss, mortgage-department head Dan Sparks, 40, backed them up during heated debates about how much money the firm should risk. This year, the three men are expected to be paid between $5 million and $15 million apiece, people familiar with the matter say.



Under Chief Executive Lloyd Blankfein, Goldman has stood out on Wall Street for its penchant for rolling the dice with its own money. The upside of that approach was obvious in the third quarter: Despite credit-market turmoil, Goldman earned $2.9 billion, its second-best three-month period ever. Mr. Blankfein is set to be paid close to $70 million this year, according to one person familiar with the matter.

Goldman's success at wringing profits out of the subprime fiasco, however, raises questions about how the firm balances its responsibilities to its shareholders and to its clients. Goldman's mortgage department underwrote collateralized debt obligations, or CDOs, complex securities created from pools of subprime mortgages and other debt. When those securities plunged in value this year, Goldman's customers suffered major losses, as did units within Goldman itself, thanks to their CDO holdings. The question now being raised: Why did Goldman continue to peddle CDOs to customers early this year while its own traders were betting that CDO values would fall? A spokesman for Goldman Sachs declined to comment on the issue.

The structured-products trading group that executed the winning trades isn't involved in selling CDOs minted by Goldman, a task handled by others. Its principal job is to "make a market" for Goldman clients trading various financial instruments tied to mortgage-backed securities. That is, the group handles clients' buy and sell orders, often stepping in on the other side of trades if no other buyer or seller is available.



The group also has another mission: If it spots opportunity, it can trade Goldman's own capital to make a profit. And when it does, it doesn't necessarily have to share such information with clients, who may be making opposite bets. This year, Goldman's traders did a brisk business handling trades for clients who were bullish on the subprime-mortgage-securities market. At the same time, they used Goldman's money to bet that that market would fall.

Tight Leash

Financial firms have good reason to keep a tight leash on proprietary traders. In 1995, bad bets by Nicholas Leeson, a young trader, led to $1.4 billion in losses and the collapse of Barings PLC. Last year, the hedge fund Amaranth Advisors shut down after a young Canadian trader lost more than $6 billion on natural-gas trades. But big trading wins such as George Soros's 1992 bet against the British pound, which netted more than $1 billion for his hedge fund, tend to be talked about for years.

The subprime trading gains notched by Messrs. Birnbaum and Swenson and their Goldman associates are large by recent Wall Street standards. Traders at Deutsche Bank AG and Morgan Stanley also bet against the subprime-mortgage market this year, but in each case, their gains were essentially wiped out because their firms underestimated how far the markets would fall. New York hedge-fund company Paulson & Co. also turned a considerable profit on the subprime meltdown this year, as did Hayman Capital Partners, a Dallas-based hedge-fund firm, say people familiar with the matter.

As recently as a year ago, few on Wall Street thought that the market for home loans made to risky borrowers, known as subprime mortgages, was heading for disaster. At that point, Goldman was bullish on bonds backed by such loans.

Hashing Out Risk

Last December, Mr. Sparks, a longtime trader of bond-related products, was named head of Goldman's 400-person mortgage department. That gave him a seat on the firm's risk committee, which numbers about 30 and meets weekly to hash out the firm's risk profile. It also gave him authority over the structured-products trading group, which then had just eight traders and was run jointly by Mr. Swenson and David Lehman, 30, a former Deutsche Bank trader.

Mr. Swenson, known as Swenny on the trading desk, is a former Williams College hockey player with four children and an acid wit. A veteran trader of asset-backed securities, he joined Goldman in 2000. In late 2005, he helped persuade Mr. Birnbaum, a Goldman veteran, to join the group. Mr. Birnbaum had developed and traded a new security tied to mortgage rates.

Mr. Swenson and Mr. Sparks, then No. 2 in the mortgage department, wanted Mr. Birnbaum to try his hand at trading related to the first ABX index, which was scheduled to launch in January 2006. Because securities backed by subprime mortgages trade privately and infrequently, their values are hard to determine. The ABX family of indexes was designed to reflect their values based on instruments called credit-default swaps. These swaps, in essence, are insurance contracts that pay out if the securities backed by subprime mortgages decline in value. Such swaps trade more actively, with their values rising and falling based on market sentiments about subprime default risk.

Messrs. Swenson and Sparks told Mr. Birnbaum the ABX was going to be a hot product, according to people with knowledge of their pitch.

They were right. On the first day of trading, Goldman netted $1 million in trading profits, people familiar with the matter say. But the index was tough to trade. In comparison to huge markets like Treasury bonds, there wasn't much buying and selling. That meant that Mr. Swenson's team nearly always had to use Goldman's capital to complete trades for clients looking to buy or sell.

Signs of Weakness

Last December, David Viniar, Goldman's chief financial officer, gave the group a big push, suggesting that it adopt a more-bearish posture on the subprime market, according to people familiar with his instructions. During a discussion with Mr. Sparks and others, Mr. Viniar noted that Goldman had big exposure to the subprime mortgage market because of CDOs and other complex securities it was holding, these people say. Emerging signs of weakness in the market, meant that Goldman needed to hedge its bets, the group concluded, these people say.

Mr. Swenson and his traders began shorting certain slices of the ABX, or betting against them, by buying credit-default swaps. At that time, new subprime mortgages still were being pumped out at a rapid clip, and gloom hadn't yet descended on the market. As a result, the swaps were relatively cheap.

Still, trading volume was thin, so it took months for the group to accumulate enough swaps to fully hedge Goldman's exposure to the subprime market. By February, Goldman had built up a sizable short position, and was poised to profit from the subprime meltdown.

The timing was nearly perfect. Goldman's bets were focused on an ABX index that reflects the value of a basket of securities that came to market in early 2006, known as the 06-2 index. Goldman bet that the riskiest portion of that index – a sub-index that reflects the value of the slices of the securities with the lowest credit ratings – would plunge in value. This January, as concerns about subprime mortgages grew, that sub-index dropped from about 95 to below 90. The traders handling the ABX trades were sitting on big profits.

Like other Wall Street firms, Goldman weighs its financial risk by calculating its average daily "value at risk," or VaR. It's meant to be a measure of how much money the firm could lose under adverse market conditions. Because the ABX had become so volatile, the VaR connected to the trades was soaring.

Goldman's co-president, Gary Cohn, who oversees the firm's trading business, became a frequent visitor, as did the firm's risk managers. More than once, Mr. Sparks was summoned to Mr. Blankfein's office to discuss the market. Goldman's top executives understood the group's strategy, say people with knowledge of the matter, but were uncompromising about the VaR. They demanded that risk be cut by as much as 50%, these people say.

Messrs. Swenson and Birnbaum, however, argued that the mortgage market was heading down, and Goldman should take full advantage by maintaining large short positions, people familiar with the matter say.

One day in late February, with the riskiest portion of the 06-2 index heading toward 60, the discussion about what to do grew heated, these people say. Mr. Birnbaum argued that Goldman would be leaving money on the table by unwinding some of the trades his group had used to bet on the mortgage market's decline.

"This is the wrong price" to close out the positions, Mr. Birnbaum snapped at a colleague assigned to help reduce risk, slamming down his phone receiver, these people say. He was overruled.

In March and April, the risky portion of the 06-2 index, which had taken a beating in February, bounced back from near 60 into the mid-70s. By then, the CDO underwriting business, which had been lucrative for Goldman, Merrill Lynch & Co. and other Wall Street firms, was slowing dramatically. Potential buyers had grown worried about the market.

Thanks to the wager that the ABX index would fall, Goldman's mortgage department earned several hundred million dollars during the first quarter, say people familiar with the matter. But the traders had unwound that bet in the weeks that followed. That left Goldman unhedged against further carnage, a worrisome situation for the second quarter.

In late April, Mr. Sparks, the mortgage-department chief, met with Mr. Cohn, the trading head, Mr. Viniar, the chief financial officer, and a couple of other senior executives. "We've got a big problem," Mr. Sparks told them as they paged through a handout listing the declining values of Goldman's CDO portfolio, according to people with knowledge of the meeting. Prices were heading straight down, he told them. He suggested that Goldman cancel a number of pending CDO deals, these people say, and sell whatever it could of the firm's roughly $10 billion in CDOs and related securities – probably at a loss.

Into the Red

Led by Mr. Lehman, the co-head of the structured-products trading group, Goldman began selling off the majority of its CDO holdings. The losses pushed the mortgage group into the red for the second quarter.

By then, the subprime-mortgage market was cratering. Dozens of lenders had filed for bankruptcy protection, and legions of subprime borrowers were losing their homes. At Bear Stearns Cos., two internal hedge funds that had invested in risky portions of CDOs and other securities were struggling. Merrill and Citigroup Inc., among others, were sitting on billions of dollars in depreciating mortgage holdings.

Although it had become more expensive to wager against the ABX index, Messrs. Swenson and Birnbaum got a green light to once again ratchet up the firm's bet that securities backed by subprime mortgages would fall further. In July, the riskiest portion of the index plunged.

No Time for Breaks

The structured-products traders were working long hours. Mr. Swenson would leave his home in Northern New Jersey in time to hit the gym and be at his desk by 7:30 a.m. When Mr. Birnbaum arrived from his Manhattan loft, they'd begin executing large trades on behalf of clients. There was no time for breaks. They took breakfast and lunch at their desks – for Mr. Swenson, the same chicken-and-vegetable salad every day from a nearby deli; for Mr. Birnbaum, an egg-white sandwich for breakfast, a chicken or turkey sandwich for lunch.

Mr. Sparks, the mortgage chief, climbed into his car at 5:30 each morning for the drive in from New Canaan, Conn. To calm his nerves, he'd stop by the gym in Goldman's downtown building to briefly jump rope and lift weights. Sometimes he worked past midnight, arriving home exhausted. He canceled a family ski trip to Wyoming. Although he loved to attend Texas A&M football games and owned a second home near the university, he decided not to join his wife and two children on more than one trip. (Mr. Sparks is a major donor to the university's athletic program.)

By late July, the Bear Stearns funds had collapsed and rumors were circulating of multibillion-dollar CDO losses at Merrill. Goldman was raking in profits.

But once again, concern was growing about VaR, the all-important measure of risk. At one point in July, senior executives called another meeting to demand the mortgage traders pull back, according to people familiar with the matter. The traders agreed.

Ratcheting Back

Around Labor Day, Mr. Birnbaum was asked to ratchet back one of his short positions by $250 million, according to Hayman Capital managing partner Kyle Bass, a client who had similar positions at the time. Mr. Bass says he made $100 million by relieving Goldman of that particular short bet. "It appeared to me that [the traders] constantly fought a VaR battle with the firm once the market started to break," says Mr. Bass.

In the first three quarters of its fiscal year, Goldman's VaR rose 38%, ending that period at $139 million per day, an all-time high, regulatory filings indicate.

During the third quarter ended Aug. 30, the structured-products trading group made more than $1 billion, say people knowledgeable about its performance. That helped the mortgage department notch record quarterly earnings of $800 million, these people say.

The subprime market continued to deteriorate through the fall. Both Merrill and Citigroup announced massive write-downs connected to the subprime mess, and their chief executive officers resigned.

Goldman pressed forward with its bearish bets on the ABX index, people familiar with its strategy say. In October, Goldman's mortgage unit moved from one downtown Manhattan office building to another. Despite their stellar year, traders were crowded into a low-ceiling floor where 150 employees shared one small men's room.

In late November, Mr. Sparks summoned Messrs. Birnbaum and Swenson to his office for separate visits. He thanked each trader for what he had done for the firm.

But there has been no time to relax. Two weeks into Goldman's new fiscal year, credit markets are looking bleaker than ever. Already, analysts are trimming their estimates of how much Goldman and other Wall Street firms will make in the coming year.

THE NEW YORK TIMES

Sunday, December 6, 2009

OFF THE SHELF

Devin Leonard

Economy's Loss Was One Man's Gain

There has been no shortage of books about Wall Street leaders who made billions of dollars disappear in the financial crisis. But as the Wall Street Journal reporter Gregory Zuckerman writes in "The Greatest Trade Ever," (Broadway Books, 295 pages) the financial crisis was a goldmine for a small group of investors. One of them, John Paulson, founder of Paulson & Company, a New York hedge fund, made $15 billion in 2007 by shorting the housing bubble.

How did he do it? His fund purchased insurance contracts – called credit default swaps – on securitized mortgage debt at the peak of the real estate boom. Their value soared when the subprime crisis arrived. Mr. Paulson personally took home $4 billion of his fund's take.

Mr. Zuckerman argues that Mr. Paulson's lucrative bets – it wasn't a single trade – put him in the pantheon of legendary investors like Warren E. Buffett, George Soros and Bernard Baruch.

"They also made him one of the richest people in the world, wealthier than Steven Spielberg, Mark Zuckerberg and David Rockefeller Sr.," he writes.

Mr. Zuckerman is a first-rate reporter who is also able to explain the complexities of real estate finance in layman's terms. At times, "The Greatest Trade Ever" (the subtitle is "The Behind-the-Scenes Story of

How John Paulson Defied Wall Street and Made Financial History") reads like a thriller.

But as you might have already discerned from the overly exuberant title, his book lacks perspective. Mr. Zuckerman depicts Mr. Paulson as a hero for seeing through "the hubris and failure of Wall Street and the financial sector."

Mr. Paulson did indeed see through Wall Street hubris. But if you read this book closely, you realize he's no hero.

The author clearly considers Mr. Paulson morally superior to the leaders of investment banks like Bear Stearns and Lehman Brothers and subprime mortgage lenders like Countrywide Financial and New Century, all of whom are vilified.

But is he really? It's true that the bearish Mr. Paulson enriched his investors while his bullish counterparts helped bring about a global economic crisis that impoverished countless people. But he wouldn't have made his billions if those players had acted more prudently.

According to Mr. Zuckerman, Mr. Paulson persuaded Goldman Sachs and Deutsche Bank to put together securitized collateralized debt obligations (known as C.D.O.'s), which were filled with nasty mortgages that he could then short.

Of course, nobody told the suckers – er, investors – who bought those C.D.O.'s that they were designed to help a man who wanted the most toxic mortgages imaginable so he could profit when they went sour. But Mr. Zuckerman doesn't make much of this scandal – and it is a scandal – perhaps because he doesn't want to taint his supposedly heroic central character.

This isn't the only instance in which Mr. Zuckerman bends over backward to present Mr. Paulson in a favorable light. He goes to great lengths to depict him as a self-effacing regular guy who takes the bus and dresses unfashionably. In short, the author would like us to think that this hedge fund manager is very un-Wall Street.

Perhaps. But Mr. Zuckerman also explains that Mr. Paulson, who grew up in Queens, marched off to Wall Street for the same reason everybody else does: to make piles of money.

We learn in "The Greatest Trade Ever" that, in his 30s, Mr. Paulson had a loft in SoHo where he mingled with models, celebrities and other bankers. After turning 40, Mr. Zuckerman writes, Mr. Paulson married his attractive assistant. They settled down to raise their daughters in a $15 million, six-story mansion, complete with indoor pool, on the Upper East Side.

The former sybarite then became something of a prig, by Mr. Zuckerman's account, scolding his friends for using foul language and his employees for eating pizza, which he considered unhealthy. That may not be typical Wall Street behavior. The rest of it sounds familiar, though.

Luckily for Mr. Zuckerman – and his readers – Mr. Paulson is not the only character in the book. There is also Paolo Pelligrini, a 50-year-old Italian analyst who is living in a one-bedroom rental in Westchester after washing out at the investment bank Lazard Frêres and breaking up with his second wife, a wealthy New York socialite.

Mr. Paulson, an old Wall Street acquaintance, throws him a lifeline in the form of a job offer. Mr.

Pelligrini reciprocates by throwing himself into his work and helps his boss create his winning strategy.

There is Mr. Paulson's friend, Jeffery Green, a Los Angeles real estate investor who pals around with Mike Tyson and Paris Hilton. He falls out with Mr. Paulson after learning of his friend's investment strategy and making his own bets again[st] the boom.

Jeffery Libert, another old acquaintance, also decides to buy credit default swaps. But he is racked with guilt, Mr. Zuckerman writes, when he finds himself wishing for homeowners to default so he can make his money. It's a rare moment of introspection in "The Greatest Trade Ever." For the most part, the people in Mr. Zuckerman's book couldn't be happier when the housing market collapses.

At the end of the book, Mr. Paulson has more money than he will ever be able to spend. He gives $15 million to the Center for Responsible Lending, a non-profit that helps families facing foreclosure. That's not much for a guy who made $4 billion in a single year.

Mr. Buffett and Mr. Soros have been more generous with their earnings. If Mr. Paulson wants to be remembered as a hero, he might want to do more for the people who are on the wrong side of his trades.

GOLDMAN SACHS

MEDIA RELATIONS - IN THE NEWS

Goldman Sachs Responds to *The New York Times* on Synthetic Collateralized Debt Obligations

Background: *The New York Times* published a story on December 24th primarily focused on the synthetic collateralized debt obligation business of Goldman Sachs. In response to questions from the paper prior to publication, Goldman Sachs made the following points.

As reporters and commentators examine some of the aspects of the financial crisis, interest has gravitated toward a variety of products associated with the mortgage market. One of these products is synthetic collateralized debt obligations (CDOs), which are referred to as synthetic because the underlying credit exposure is taken via credit default swaps rather than by physically owning assets or securities. The following points provide a summary of how these products worked and why they were created.

Any discussion of Goldman Sachs' association with this product must begin with our overall activities in the mortgage market. Goldman Sachs, like other financial institutions, suffered significant losses in its residential mortgage portfolio due to the deterioration of the housing market (we disclosed $1.7 billion in residential mortgage exposure write-downs in 2008). These losses would have been substantially higher had we not hedged. We consider hedging the cornerstone of prudent risk management.

Synthetic CDOs were an established product for corporate credit risk as early as 2002. With the introduction of credit default swaps referencing mortgage products in 2004-2005, it is not surprising that market participants would consider synthetic CDOs in the context of mortgages. Although precise tallies of synthetic CDO issuance are not readily available, many observers would agree the market size was in the hundreds of billions of dollars.

Many of the synthetic CDOs arranged were the result of demand from investing clients seeking long exposure.

Synthetic CDOs were popular with many investors prior to the financial crisis because they gave investors the ability to work with banks to design tailored securities which met their particular criteria, whether it be ratings, leverage or other aspects of the transaction.

The buyers of synthetic mortgage CDOs were large, sophisticated investors. These investors had significant in-house research staff to analyze portfolios and structures and to suggest modifications. They did not rely upon the issuing banks in making their investment decisions.

For static synthetic CDOs, reference portfolios were fully disclosed. Therefore, potential buyers could simply decide not to participate if they did not like some or all the securities referenced in a particular portfolio.

Synthetic CDOs require one party to be long the risk and the other to be short so without the short position, a transaction could not take place.

It is fully disclosed and well known to investors that banks that arranged synthetic CDOs took the initial short position and that these positions could either have been applied as hedges against other risk positions or covered via trades with other investors.

Most major banks had similar businesses in synthetic mortgage CDOs.

As housing price growth slowed and then turned negative, the disruption in the mortgage market resulted in synthetic CDO losses for many investors and financial institutions, including Goldman Sachs, effectively putting an end to this market.

THE NEW YORK TIMES

New York, Thursday, December 24, 2009

VOL. CLIX No. 54,899

Banks Bundled Debt, Bet Against It and Won

By GRETCHEN MORGENSON and LOUISE STORY

In late October 2007, as the financial markets were starting to come unglued, a Goldman Sachs trader, Jonathan M. Egol, received very good news. At 37, he was named a managing director at the firm.

Mr. Egol, a Princeton graduate, had risen to prominence inside the bank by creating mortgage-related securities, named Abacus, that were at first intended to protect Goldman from investment losses if the housing market collapsed. As the market soured, Goldman created even more of these securities, enabling it to pocket huge profits.

Goldman's own clients who bought them, however, were less fortunate.

Pension funds and insurance companies lost billions of dollars on securities that they believed were solid investments, according to former Goldman employees with direct knowledge of the deals who asked not to be identified because they have confidentiality agreements with the firm.

Goldman was not the only firm that peddled these complex securities — known as synthetic collateralized debt obligations, or C.D.O.'s — and then made financial bets against them, called selling short in Wall Street parlance. Others that created similar securities and then bet they would fail, according to Wall Street traders, include Deutsche Bank and Morgan Stanley, as well as smaller firms like Tricadia

Inc., an investment company whose parent firm was overseen by Lewis A. Sachs, who this year became a special counselor to Treasury Secretary Timothy F. Geithner.

How these disastrously performing securities were devised is now the subject of scrutiny by investigators in Congress, at the Securities and Exchange Commission and at the Financial Industry Regulatory Authority, Wall Street's self-regulatory organization, according to people briefed on the investigations. Those involved with the inquiries declined to comment.

While the investigations are in the early phases, authorities appear to be looking at whether securities laws or rules of fair dealing were violated by firms that created and sold these mortgage-linked debt instruments and then bet against the clients who purchased them, people briefed on the matter say.

One focus of the inquiry is whether the firms creating the securities purposely helped to select especially risky mortgage-linked assets that would be most likely to crater, setting their clients up to lose billions of dollars if the housing market imploded.

Some securities packaged by Goldman and Tricadia ended up being so vulnerable that they soured within months of being created.

Goldman and other Wall Street firms maintain there is nothing improper about synthetic C.D.O.'s, saying that they typically employ many trading techniques to hedge investments and protect against losses. They add that many prudent investors often do the same. Goldman used these securities initially to offset any potential losses stemming from its positive bets on mortgage securities.

But Goldman and other firms eventually used the C.D.O.'s to place unusually large negative bets that were not mainly for hedging purposes, and investors and industry experts say that put the firms at odds with their own clients' interests.

"The simultaneous selling of securities to customers and shorting them because they believed they were going to default is the most cynical use of credit information that I have ever seen," said Sylvain R. Raynes, an expert in structured finance at R & R Consulting in New York. "When you buy protection against an event that you have a hand in causing, you are buying fire insurance on someone else's house and then committing arson."

Investment banks were not alone in reaping rich rewards by placing trades against synthetic C.D.O.'s. Some hedge funds also benefited, including Paulson & Company, according to former Goldman workers and people at other banks familiar with that firm's trading.

Michael DuVally, a Goldman Sachs spokesman, declined to make Mr. Egol available for comment. But Mr. DuVally said many of the C.D.O.'s created by Wall Street were made to satisfy client demand for such products, which the clients thought would produce profits because they had an optimistic view of the housing market. In addition, he said that clients knew Goldman might be betting against mortgages linked to the securities, and that the buyers of synthetic mortgage C.D.O.'s were large, sophisticated investors, he said.

The creation and sale of synthetic C.D.O.'s helped make the financial crisis worse than it might otherwise have been, effectively multiplying losses by providing more securities to bet against. Some $8 billion in these securities remain on the books at American International Group, the giant insurer rescued by the government in September 2008.

From 2005 through 2007, at least $108 billion in these securities was issued, according to Dealogic, a financial data firm. And the actual volume was much higher because synthetic C.D.O.'s and other customized trades are unregulated and often not reported to any financial exchange or market.

Goldman Saw It Coming

Before the financial crisis, many investors — large American and European banks, pension funds, insurance companies and even some hedge funds — failed to recognize that overextended borrowers would default on their mortgages, and they kept increasing their investments in mortgage-related securities. As the mortgage market collapsed, they suffered steep losses.

* * *

One former Goldman salesman wrote a novel about the crisis. A Deutsche Bank trader passed out T-shirts for investors hoping to profit on a housing bust.

A handful of investors and Wall Street traders, however, anticipated the crisis. In 2006, Wall Street had introduced a new index, called the ABX, that became a way to invest in the direction of mortgage securities. The index allowed traders to bet on or against pools of mortgages with different risk characteristics, just as stock indexes enable traders to bet on whether the overall stock market, or technology stocks or bank stocks, will go up or down.

Goldman, among others on Wall Street, has said since the collapse that it made big money by using the ABX to bet against the housing market. Worried about a housing bubble, top Goldman executives decided in December 2006 to change the firm's overall stance on the mortgage market, from positive to negative, though it did not disclose that publicly.

Even before then, however, pockets of the investment bank had also started using C.D.O.'s to place bets against mortgage securities, in some cases to hedge the firm's mortgage investments, as protection against a fall in housing prices and an increase in defaults.

Mr. Egol was a prime mover behind these securities. Beginning in 2004, with housing prices soaring and the mortgage mania in full swing, Mr. Egol began creating the deals known as Abacus. From 2004 to 2008, Goldman issued 25 Abacus deals, according to Bloomberg, with a total value of $10.9 billion.

Abacus allowed investors to bet for or against the mortgage securities that were linked to the deal. The C.D.O.'s didn't contain actual mortgages. Instead, they consisted of credit-default swaps, a type of insurance that pays out when a borrower defaults. These swaps made it much easier to place large bets on mortgage failures.

Rather than persuading his customers to make negative bets on Abacus, Mr. Egol kept most of these wagers for his firm, said five former Goldman employees who spoke on the condition of anonymity. On occasion, he allowed some hedge funds to take some of the short trades.

Mr. Egol and Fabrice Tourre, a French trader at Goldman, were aggressive from the start in trying to make the assets in Abacus deals look better than they were, according to notes taken by a Wall Street investor during a phone call with Mr. Tourre and another Goldman employee in May 2005.

On the call, the two traders noted that they were trying to persuade analysts at Moody's Investors Service, a credit rating agency, to assign a higher rating to one part of an Abacus C.D.O. but were having trouble, according to the investor's notes, which were provided by a colleague who asked for anonymity because he was not authorized to release them. Goldman declined to discuss the selection of the assets in the C.D.O.'s, but a spokesman said investors could have rejected the C.D.O. if they did not like the assets.

Goldman's bets against the performances of the Abacus C.D.O.'s were not worth much in 2005 and 2006, but they soared in value in 2007 and 2008 when the mortgage market collapsed. The trades gave Mr. Egol a higher profile at the bank, and he was among a group promoted to managing director on Oct. 24, 2007.

"Egol and Fabrice were way ahead of their time," said one of the former Goldman workers. "They saw the writing on the wall in this market as early as 2005." By creating the Abacus C.D.O.'s, they helped protect Goldman against losses that others would suffer.

As early as the summer of 2006, Goldman's sales desk began marketing short bets using the ABX index to hedge funds like Paulson & Company, Magnetar and Soros Fund Management, which invests for the billionaire George Soros. John Paulson, the founder of Paulson & Company, also would later take some of the shorts from the Abacus deals, helping him profit when mortgage bonds collapsed. He declined to comment.

A Deal Gone Bad, for Some

The woeful performance of some C.D.O.'s issued by Goldman made them ideal for betting against. As of September 2007, for example, just five months after Goldman had sold a new Abacus C.D.O., the ratings on 84 percent of the mortgages underlying it had been downgraded, indicating growing concerns about borrowers' ability to repay the loans, according to research from UBS, the big Swiss bank. Of more than 500 C.D.O.'s analyzed by UBS, only two were worse than the Abacus deal.

Goldman created other mortgage-linked C.D.O.'s that performed poorly, too. One, in October 2006, was a $800 million C.D.O. known as Hudson Mezzanine. It included credit insurance on mortgage and subprime mortgage bonds that were in the ABX index; Hudson buyers would make money if the housing market stayed healthy — but lose money if it collapsed. Goldman kept a significant amount of the financial bets against securities in Hudson, so it would profit if they failed, according to three of the former Goldman employees.

A Goldman salesman involved in Hudson said the deal was one of the earliest in which outside investors raised questions about Goldman's incentives. "Here we are selling this, but we think the market is going the other way," he said.

A hedge fund investor in Hudson, who spoke on the condition of anonymity, said that because Goldman was betting against the deal, he wondered whether the bank built Hudson with "bonds they really think are going to get into trouble."

Indeed, Hudson investors suffered large losses. In March 2008, just 18 months after Goldman created that C.D.O., so many borrowers had defaulted that holders of the security paid out about $310 million to Goldman and others who had bet against it, according to correspondence sent to Hudson investors.

The Goldman salesman said that C.D.O. buyers were not misled because they were advised that Goldman was placing large bets against the securities. "We were very open with all the risks that we thought we sold. When you're facing a tidal wave of people who want to invest, it's hard to stop them," he said. The salesman added that investors could have placed bets against Abacus and similar C.D.O.'s if they had wanted to.

A Goldman spokesman said the firm's negative bets didn't keep it from suffering losses on its mortgage assets, taking $1.7 billion in write-downs on them in 2008; but he would not say how much the bank had since earned on its short positions, which former Goldman workers say will be far more lucrative over time. For instance, Goldman profited to the tune of $1.5 billion from one series of mortgage-related trades by Mr. Egol with Wall Street rival Morgan Stanley, which had to book a steep loss, according to people at both firms.

Credit...Left, Treasury Department; Kevin Wolf/Associated Press

Lewis Sachs, left, who oversaw C.D.O.'s before becoming a Treasury adviser, and John Paulson, whose company profited as the housing market collapsed.

Tetsuya Ishikawa, a salesman on several Abacus and Hudson deals, left Goldman and later published a novel, "How I Caused the Credit Crunch." In it, he wrote that bankers deserted their clients who had bought mortgage bonds when that market collapsed: "We had moved on to hurting others in our quest for self-preservation." Mr. Ishikawa, who now works for another financial firm in London, declined to comment on his work at Goldman.

Profits From a Collapse

Just as synthetic C.D.O.'s began growing rapidly, some Wall Street banks pushed for technical modifications governing how they worked in ways that made it possible for C.D.O.'s to expand even faster, and also tilted the playing field in favor of banks and hedge funds that bet against C.D.O.'s, according to investors.

In early 2005, a group of prominent traders met at Deutsche Bank's office in New York and drew up a new system, called Pay as You Go. This meant the insurance for those betting against mortgages would pay out more quickly. The traders then went to the International Swaps and Derivatives Association, the group that governs trading in derivatives like C.D.O.'s. The new system was presented as a fait accompli, and adopted.

Other changes also increased the likelihood that investors would suffer losses if the mortgage market tanked. Previously, investors took losses only in certain dire "credit events," as when the mortgages associated with the C.D.O. defaulted or their issuers went bankrupt.

But the new rules meant that C.D.O. holders would have to make payments to short sellers under less onerous outcomes, or "triggers," like a ratings downgrade on a bond. This meant that anyone who bet against a C.D.O. could collect on the bet more easily.

"In the early deals you see none of these triggers," said one investor who asked for anonymity to preserve relationships. "These things were built in to provide the dealers with a big payoff when something bad happened."

Banks also set up ever more complex deals that favored those betting against C.D.O.'s. Morgan Stanley established a series of C.D.O.'s named after United States presidents (Buchanan and Jackson) with an unusual feature: short-sellers could lock in very cheap bets against mortgages, even beyond the life of the mortgage bonds. It was akin to allowing someone paying a low insurance premium for coverage on one automobile to pay the same on another one even if premiums over all had increased because of high accident rates.

At Goldman, Mr. Egol structured some Abacus deals in a way that enabled those betting on a mortgage-market collapse to multiply the value of their bets, to as much as six or seven times the face value of those C.D.O.'s. When the mortgage market tumbled, this meant bigger profits for Goldman and other short sellers — and bigger losses for other investors.

Selling Bad Debt

Other Wall Street firms also created risky mortgage-related securities that they bet against.

At Deutsche Bank, the point man on betting against the mortgage market was Greg Lippmann, a trader. Mr. Lippmann made his pitch to select hedge fund clients, arguing they should short the mortgage market. He sometimes distributed a T-shirt that read "I'm Short Your House!!!" in black and red letters.

Deutsche, which declined to comment, at the same time was selling synthetic C.D.O.'s to its clients, and those deals created more short-selling opportunities for traders like Mr. Lippmann.

Among the most aggressive C.D.O. creators was Tricadia, a management company that was a unit of

Mariner Investment Group. Until he became a senior adviser to the Treasury secretary early this year, Lewis Sachs was Mariner's vice chairman. Mr. Sachs oversaw about 20 portfolios there, including Tricadia, and its documents also show that Mr. Sachs sat atop the firm's C.D.O. management committee.

From 2003 to 2007, Tricadia issued 14 mortgage-linked C.D.O.'s, which it called TABS. Even when the market was starting to implode, Tricadia continued to create TABS deals in early 2007 to sell to investors. The deal documents referring to conflicts of interest stated that affiliates and clients of Tricadia might place bets against the types of securities in the TABS deal.

Even so, the sales material also boasted that the mortgages linked to C.D.O.'s had historically low default rates, citing a "recently completed" study by Standard & Poor's ratings agency — though fine print indicated that the date of the study was September 2002, almost five years earlier.

At a financial symposium in New York in September 2006, Michael Barnes, the co-head of Tricadia, described how a hedge fund could put on a negative mortgage bet by shorting assets to C.D.O. investors, according to his presentation, which was reviewed by The New York Times.

Mr. Barnes declined to comment. James E. McKee, general counsel at Tricadia, said, "Tricadia has never shorted assets into the TABS deals, and Tricadia has always acted in the best interests of its clients and investors."

Mr. Sachs, through a spokesman at the Treasury Department, declined to comment.

Like investors in some of Goldman's Abacus deals, buyers of some TABS experienced heavy losses. By the end of 2007, UBS research showed that two TABS deals were the eighth- and ninth-worst performing C.D.O.'s. Both had been downgraded on at least 75 percent of their associated assets within a year of being issued.

Tricadia's hedge fund did far better, earning roughly a 50 percent return in 2007 and similar profits in 2008, in part from the short bets.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

10-CV-____________ (   )

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

GOLDMAN SACHS & CO. and
FABRICE TOURRE,

Defendants.

ECF CASE

Jury Trial Demanded

COMPLAINT
[Securities Fraud]

Plaintiff, the United States Securities and Exchange Commission ("Commission"), alleges as follows against the defendants named above.

OVERVIEW

1. The Commission brings this securities fraud action against Goldman, Sachs & Co. ("GS&Co") and a GS&Co employee, Fabrice Tourre ("Tourre"), for making materially misleading statements and omissions in connection with a synthetic collateralized debt obligation ("CDO") GS&Co structured and marketed to investors. This synthetic CDO, ABACUS 2007-AC1, was tied to the performance of subprime residential mortgage-backed securities ("RMBS") and

was structured and marketed by GS&Co in early 2007 when the United States housing market and related securities were beginning to show signs of distress. Synthetic CDOs like ABACUS 2007-AC1 contributed to the recent financial crisis by magnifying losses associated with the downturn in the United States housing market.

2. GS&Co marketing materials for ABACUS 2007-AC1 — including the term sheet, flip book and offering memorandum for the CDO — all represented that the reference portfolio of RMBS underlying the CDO was selected by ACA Management LLC ("ACA"), a third-party with experience analyzing credit risk in RMBS. Undisclosed in the marketing materials and unbeknownst to investors, a large hedge fund, Paulson & Co. Inc. ("Paulson"), with economic interests directly adverse to investors in the ABACUS 2007-AC1 CDO, played a significant role in the portfolio selection process. After participating in the selection of the reference portfolio, Paulson effectively shorted the RMBS portfolio it helped select by entering into credit default swaps ("CDS") with GS&Co to buy protection on specific layers of the ABACUS 2007-AC1 capital structure. Given its financial short interest, Paulson had an economic incentive to choose RMBS that it expected to experience credit events in the near future. GS&Co did not disclose Paulson's adverse economic interests or its role in the portfolio selection process in the term sheet, flip book, offering memorandum or other marketing materials provided to investors.

3. In sum, GS&Co arranged a transaction at Paulson's request in which Paulson heavily influenced the selection of the portfolio to suit its economic interests, but failed to disclose to investors, as part of the description of the portfolio selection process

contained in the marketing materials used to promote the transaction, Paulson's role in the portfolio selection process or its adverse economic interests.

4. Tourre was principally responsible for ABACUS 2007-AC1. Tourre devised the transaction, prepared the marketing materials and communicated directly with investors. Tourre knew of Paulson's undisclosed short interest and its role in the collateral selection process. Tourre also misled ACA into believing that Paulson invested approximately $200 million in the equity of ABACUS 2007-AC1 (a long position) and, accordingly, that Paulson's interests in the collateral selection process were aligned with ACA's when in reality Paulson's interests were sharply conflicting.

5. The deal closed on April 26, 2007. Paulson paid GS&Co approximately $15 million for structuring and marketing ABACUS 2007-AC1. By October 24, 2007, 83% of the RMBS in the ABACUS 2007-AC1 portfolio had been downgraded and 17% were on negative watch. By January 29, 2008, 99% of the portfolio had been downgraded. As a result, investors in the ABACUS 2007-AC1 CDO lost over $1 billion. Paulson's opposite CDS positions yielded a profit of approximately $1 billion for Paulson.

6. By engaging in the misconduct described herein, GS&Co and Tourre directly or indirectly engaged in transactions, acts, practices and a course of business that violated Section 17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a) ("the Securities Act"), Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b) ("the Exchange Act") and Exchange Act Rule 10b-5, 17 C.F.R. §240.10b-5. The Commission seeks injunctive relief, disgorgement of profits, prejudgment interest, civil penalties and other appropriate and necessary equitable relief from both defendants.

JURISDICTION AND VENUE

7. This Court has jurisdiction over this action pursuant to Sections 21(d), 21(e), and 27 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e), and 78aa]. Each defendant, directly or indirectly, made use of the means or instruments of interstate commerce, or of the mails, or the facilities of a national securities exchange in connection with the transactions, acts, practices, and courses of business alleged herein. Certain of the acts, practices, and courses of conduct constituting the violations of law alleged herein occurred within this judicial district.

DEFENDANTS

8. **Goldman, Sachs & Co.** is the principal United States broker-dealer of The Goldman Sachs Group, Inc., a global investment banking, securities and investment management firm headquartered in New York City. GS&Co structured and marketed ABACUS 2007-AC1.

9. **Fabrice Tourre**, age 31, is a registered representative with GS&Co. Tourre was the GS&Co employee principally responsible for the structuring and marketing of ABACUS 2007-AC1. Tourre worked as a Vice President on the structured product correlation trading desk at GS&Co headquarters in New York City during the relevant period. Tourre presently works in London as an Executive Director of Goldman Sachs International.

FACTS

A. GS&CO'S CORRELATION TRADING DESK

10. GS&Co's structured product correlation trading desk was created in and around late 2004/early 2005. Among the services it provided was the structuring and marketing of a series of synthetic CDOs called "ABACUS" whose performance was tied to RMBS. GS&Co sought to protect and expand this profitable franchise in a competitive market throughout the relevant period. According to an internal GS&Co memorandum to the Goldman Sachs Mortgage Capital Committee ("MCC") dated March 12, 2007, the "ability to structure and execute complicated transactions to meet multiple client's needs and objectives is key for our franchise," and "[e]xecuting this transaction [ABACUS 2007-AC1] and others like it helps position Goldman to compete more aggressively in the growing market for synthetics written on structured products."

B. PAULSON'S INVESTMENT STRATEGY

11. Paulson & Co. Inc. ("Paulson") is a hedge fund founded in 1994. Beginning in 2006, Paulson created two funds, known as the Paulson Credit Opportunity Funds, which took a bearish view on subprime mortgage loans by buying protection through CDS on various debt securities. A CDS is an over-the-counter derivative contract under which a protection buyer makes periodic premium payments and the protection seller makes a contingent payment if a reference obligation experiences a credit event.

12. RMBS are securities backed by residential mortgages. Investors receive payments out of the interest and principal on the underlying mortgages.

Paulson developed an investment strategy based upon the belief that, for a variety of reasons, certain mid-and-subprime RMBS rated “Triple B,” meaning bonds rated “BBB” by S&P or “Baa2” by Moody’s, would experience credit events. The Triple B tranche is the lowest investment grade RMBS and, after equity, the first part of the capital structure to experience losses associated with a deterioration of the underlying mortgage loan portfolio.

13. CDOs are debt securities collateralized by debt obligations including RMBS. These securities are packaged and generally held by a special purpose vehicle (“SPV”) that issues notes entitling their holders to payments derived from the underlying assets. In a synthetic CDO, the SPV does not actually own a portfolio of fixed income assets, but rather enters into CDSs that reference the performance of a portfolio (the SPV does hold some collateral securities separate from the reference portfolio that it uses to make payment obligations).

14. Paulson came to believe that synthetic CDOs whose reference assets consisted of certain Triple B-rated mid-and-subprime RMBS would experience significant losses and, under certain circumstances, even the more senior AAA-rated tranches of these so-called “mezzanine” CDOs would become worthless.

C. <u>GS&CO AND PAULSON DISCUSS A PROPOSED TRANSACTION</u>

15. Paulson performed an analysis of recent-vintage Triple B-rated RMBS and identified various bonds it expected to experience credit events. Paulson then asked GS&Co to help it buy protection, through the use of CDS, on the RMBS it had adversely

selected, meaning chosen in the belief that the bonds would experience credit events.

16. Paulson discussed with GS&Co possible transactions in which counterparties to its short positions might be found. Among the transactions considered were synthetic CDOs whose performance was tied to Triple B-rated RMBS. Paulson discussed with GS&Co the creation of a CDO that would allow Paulson to participate in selecting a portfolio of reference obligations and then effectively short the RMBS portfolio it helped select by entering into CDS with GS&Co to buy protection on specific layers of the synthetic CDO's capital structure.

17. A Paulson employee explained the investment opportunity as of January 2007 as follows:

> "It is true that the market is not pricing the subprime RMBS wipeout scenario. In my opinion this situation is due to the fact that rating agencies, CDO managers and underwriters have all the incentives to keep the game going, while 'real money' investors have neither the analytical tools nor the institutional framework to take action before the losses that one could anticipate based [on] the 'news' available everywhere are actually realized."

18. At the same time, GS&Co recognized that market conditions were presenting challenges to the successful marketing of CDO transactions backed by mortgage-related securities. For example, portions of an email in French and English sent by Tourre to a friend on January 23, 2007 stated, in English translation where applicable: "More and more leverage in the system, The whole building is about to

collapse anytime now . . . Only potential survivor, the fabulous Fab[rice Tourre] . . . standing in the middle of all these complex, highly leveraged, exotic trades he created without necessarily understanding all of the implications of those monstruosities!!!" Similarly, an email on February 11, 2007 to Tourre from the head of the GS&Co structured product correlation trading desk stated in part, "the cdo biz is dead we don't have a lot of time left."

D. INTRODUCTION OF ACA TO THE PROPOSED TRANSACTION

19. GS&Co and Tourre knew that it would be difficult, if not impossible, to place the liabilities of a synthetic CDO if they disclosed to investors that a short investor, such as Paulson, played a significant role in the collateral selection process. By contrast, they knew that the identification of an experienced and independent third-party collateral manager as having selected the portfolio would facilitate the placement of the CDO liabilities in a market that was beginning to show signs of distress.

20. GS&Co also knew that at least one significant potential investor, IKB Deutsche Industriebank AG ("IKB"), was unlikely to invest in the liabilities of a CDO that did not utilize a collateral manager to analyze and select the reference portfolio.

21. GS&Co therefore sought a collateral manager to play a role in the transaction proposed by Paulson. Contemporaneous internal correspondence reflects that GS&Co recognized that not every collateral manager would "agree to the type of names [of RMBS] Paulson want[s] to use" and put its "name at risk...on a weak quality portfolio."

22. In or about January 2007, GS&Co approached ACA and proposed that it serve as the "Portfolio Selection Agent" for a CDO transaction sponsored by Paulson. ACA previously had constructed and managed numerous CDOs for a fee. As of December 31, 2006, ACA had closed on 22 CDO transactions with underlying portfolios consisting of $15.7 billion of assets.

23. Internal GS&Co communications emphasized the advantages from a marketing perspective of having ACA associated with the transaction. For example, an internal email from Tourre dated February 7, 2007, stated:

> "One thing that we need to make sure ACA understands is that we want their name on this transaction. This is a transaction for which they are acting as portfolio selection agent, this will be important that we can use ACA's branding to help distribute the bonds."

24. Likewise, an internal GS&Co memorandum to the Goldman Sachs MCC dated March 12, 2007 described the marketing advantages of ACA's "brand-name" and "credibility":

> "We expect the strong brand-name of ACA as well as our market-leading position in synthetic CDOs of structured products to result in a successful offering."
>
> "We expect that the role of ACA as Portfolio Selection Agent will broaden the investor base for this and future ABACUS offerings."
>
> "We intend to target suitable structured product investors who have previously participated in ACA-managed cashflow CDO

> transactions or who have previously participated in prior ABACUS transactions."
>
> "We expect to leverage ACA's credibility and franchise to help distribute this Transaction."

E. PAULSON'S PARTICIPATION IN THE COLLATERAL SELECTION PROCESS

25. In late 2006 and early 2007, Paulson performed an analysis of recent-vintage Triple B RMBS and identified over 100 bonds it expected to experience credit events in the near future. Paulson's selection criteria favored RMBS that included a high percentage of adjustable rate mortgages, relatively low borrower FICO scores, and a high concentration of mortgages in states like Arizona, California, Florida and Nevada that had recently experienced high rates of home price appreciation. Paulson informed GS&Co that it wanted the reference portfolio for the contemplated transaction to include the RMBS it identified or bonds with similar characteristics.

26. On January 8, 2007, Tourre attended a meeting with representatives from Paulson and ACA at Paulson's offices in New York City to discuss the proposed transaction.

27. On January 9, 2007, GS&Co sent an email to ACA with the subject line, "Paulson Portfolio." Attached to the email was a list of 123 2006 RMBS rated Baa2. On January 9, 2007, ACA performed an "overlap analysis" and determined that it previously had purchased 62 of the 123 RMBS on Paulson's list at the same or lower ratings.

28. On January 9, 2007, GS&Co informed ACA that Tourre was "very excited by the initial portfolio feedback."

29. On January 10, 2007, Tourre sent an email to ACA with the subject line, "Transaction Summary." The text of Tourre's email began, "we wanted to summarize ACA's proposed role as 'Portfolio Selection Agent' for the transaction that would be sponsored by Paulson (the 'Transaction Sponsor')." The email continued in relevant part, "[s]tarting portfolio would be ideally what the Transaction Sponsor shared, but there is flexibility around the names."

30. On January 22, 2007, ACA sent an email to Tourre and others at GS&Co with the subject line, "Paulson Portfolio 1-22-10.xls." The text of the email began, "Attached please find a worksheet with 86 sub-prime mortgage positions that we would recommend taking exposure to synthetically. Of the 123 names that were originally submitted to us for review, we have included only 55."

31. On January 27, 2007, ACA met with a Paulson representative in Jackson Hole, Wyoming, and they discussed the proposed transaction and reference portfolio. The next day, on January 28, 2007, ACA summarized the meeting in an email to Tourre. Tourre responded via email later that day, "this is confirming my initial impression that [Paulson] wanted to proceed with you subject to agreement on portfolio and compensation structure."

32. On February 2, 2007, Paulson, Tourre and ACA met at ACA's offices in New York City to discuss the reference portfolio. Unbeknownst to ACA at the time, Paulson intended to effectively short the RMBS portfolio it helped select by entering into CDS with GS&Co to buy protection on specific layers of the synthetic CDO's capital structure. Tourre and GS&Co, of course, were fully aware that Paulson's economic interests with respect to the quality of the reference

portfolio were directly adverse to CDO investors. During the meeting, Tourre sent an email to another GS&Co employee stating, "I am at this aca paulson meeting, this is surreal." Later the same day, ACA emailed Paulson, Tourre, and others at GS&Co a list of 82 RMBS on which Paulson and ACA concurred, plus a list of 21 "replacement" RMBS. ACA sought Paulson's approval of the revised list, asking, "Let me know if these work for you at the Baa2 level."

33. On February 5, 2007, Paulson sent an email to ACA, with a copy to Tourre, deleting eight RMBS recommended by ACA, leaving the rest, and stating that Tourre agreed that 92 bonds were a sufficient portfolio.

34. On February 5, 2007, an internal ACA email asked, "Attached is the revised portfolio that Paulson would like us to commit to — all names are at the Baa2 level. The final portfolio will have between 80 and these 92 names. Are 'we' ok to say yes on this portfolio?" The response was, "Looks good to me. Did [Paulson] give a reason why they kicked out all the Wells [Fargo] deals?" Wells Fargo was generally perceived as one of the higher-quality subprime loan originators.

35. On or about February 26, 2007, after further discussion, Paulson and ACA came to an agreement on a reference portfolio of 90 RMBS for ABACUS 2007-AC1.

F. <u>GS&CO MISLED INVESTORS BY REPRESENTING THAT ACA SELECTED THE PORTFOLIO WITHOUT DISCLOSING PAULSON'S SIGNIFICANT ROLE IN DETERMINING THE PORTFOLIO AND ITS ADVERSE ECONOMIC INTERESTS</u>

36. GS&Co's marketing materials for ABACUS 2007-AC1 were false and misleading because they represented that ACA selected the reference portfolio while omitting any mention that Paulson, a party with economic interests adverse to CDO investors, played a significant role in the selection of the reference portfolio.

37. For example, a 9-page term sheet for ABACUS 2007-AC1 finalized by GS&Co on or about February 26, 2007, described ACA as the "Portfolio Selection Agent" and stated in bold print at the top of the first page that the reference portfolio of RMBS had been "selected by ACA." This document contained no mention of Paulson, its economic interests in the transaction, or its role in selecting the reference portfolio.

38. Similarly, a 65-page flip book for ABACUS 2007-AC1 finalized by GS&Co on or about February 26, 2007 represented on its cover page that the reference portfolio of RMBS had been "Selected by ACA Management, LLC." The flip book included a 28-page overview of ACA describing its business strategy, senior management team, investment philosophy, expertise, track record and credit selection process, together with a 7-page section of biographical information on ACA officers and employees. Investors were assured that the party selecting the portfolio had an "alignment of economic interest" with investors. This document contained no mention of Paulson, its economic interests in the transaction, or its role in selecting the reference portfolio.

39. Tourre had primary responsibility for preparing the term sheet and flip book.

40. The Goldman Sachs MCC, which included senior-level management of GS&Co, approved the ABACUS 2007-AC1 on or about March 12, 2007. GS&Co expected to earn between $15-and-$20 million for structuring and marketing ABACUS 2007-AC1.

41. On or about April 26, 2007, GS&Co finalized a 178-page offering memorandum for ABACUS 2007-AC1. The cover page of the offering memorandum included a description of ACA as "Portfolio Selection Agent." The Transaction Overview, Summary and Portfolio Selection Agent sections of the memorandum all represented that the reference portfolio of RMBS had been selected by ACA. This document contained no mention of Paulson, its economic interests in the transaction, or its role in selecting the reference portfolio.

42. Tourre reviewed at least the Summary section of the offering memorandum before it was sent to potential investors.

43. Although the marketing materials for ABACUS 2007-AC1 made no mention of Paulson or its role in the transaction, internal GS&Co communications clearly identified Paulson, its economic interests, and its role in the transaction. For example, the March 12, 2007 MCC memorandum describing the transaction stated, "Goldman is effectively working an order for Paulson to buy protection on specific layers of the [ABACUS 2007-]AC1 capital structure."

G. GS&CO MISLED ACA INTO BELIEVING PAULSON WAS LONG EQUITY

44. GS&Co also misled ACA into believing that Paulson was investing in the equity of ABACUS 2007-AC1 and therefore shared a long interest with

CDO investors. The equity tranche is at the bottom of the capital structure and the first to experience losses associated with deterioration in the performance of the underlying RMBS. Equity investors therefore have an economic interest in the successful performance of a reference RMBS portfolio. As of early 2007, ACA had participated in a number of CDO transactions involving hedge funds that invested in the equity tranche.

45. Had ACA been aware that Paulson was taking a short position against the CDO, ACA would have been reluctant to allow Paulson to occupy an influential role in the selection of the reference portfolio because it would present serious reputational risk to ACA, which was in effect endorsing the reference portfolio. In fact, it is unlikely that ACA would have served as portfolio selection agent had it known that Paulson was taking a significant short position instead of a long equity stake in ABACUS 2007-AC1. Tourre and GS&Co were responsible for ACA's misimpression that Paulson had a long position, rather than a short position, with respect to the CDO.

46. On January 8, 2007, Tourre attended a meeting with representatives from Paulson and ACA at Paulson's offices in New York City to discuss the proposed transaction. Paulson's economic interest was unclear to ACA, which sought further clarification from GS&Co. Later that day, ACA sent a GS&Co sales representative an email with the subject line "Paulson meeting" that read:

> "I have no idea how it went — I wouldn't say it went poorly, not at all, but I think it didn't help that we didn't know exactly how they

> [Paulson] want to participate in the space. Can you get us some feedback?"

47. On January 10, 2007, Tourre emailed ACA a "Transaction Summary" that included a description of Paulson as the "Transaction Sponsor" and referenced a "Contemplated Capital Structure" with a "[0]% - [9]%: pre-committed first loss" as part of the Paulson deal structure. The description of this [0]% - [9]% tranche at the bottom of the capital structure was consistent with the description of an equity tranche and ACA reasonably believed it to be a reference to the equity tranche. In fact, GS&Co never intended to market to anyone a "[0]%-[9]%" first loss equity tranche in this transaction.

48. On January 12, 2007, Tourre spoke by telephone with ACA about the proposed transaction. Following that conversation, on January 14, 2007, ACA sent an email to the GS&Co sales representative raising questions about the proposed transaction and referring to Paulson's equity interest. The email, which had the subject line "Call with Fabrice [Tourre] on Friday," read in pertinent part:

> "I certainly hope I didn't come across too antagonistic on the call with Fabrice [Tourre] last week but the structure looks difficult from a debt investor perspective. I can understand Paulson's equity perspective but for us to put our name on something, we have to be sure it enhances our reputation."

49. On January 16, 2007, the GS&Co sales representative forwarded that email to Tourre. As of that date, Tourre knew, or was reckless in not knowing, that ACA had been misled into believing

Paulson intended to invest in the equity of ABACUS 2007-AC1.

50. Based upon the January 10, 2007, "Transaction Summary" sent by Tourre, the January 12, 2007 telephone call with Tourre and continuing communications with Tourre and others at GS&Co, ACA continued to believe through the course of the transaction that Paulson would be an equity investor in ABACUS 2007-AC1.

51. On February 12, 2007, ACA's Commitments Committee approved the firm's participation in ABACUS as portfolio selection agent. The written approval memorandum described Paulson's role as follows: "the hedge fund equity investor wanted to invest in the 0-9% tranche of a static mezzanine ABS CDO backed 100% by subprime residential mortgage securities." Handwritten notes from the meeting reflect discussion of "portfolio selection work with the equity investor."

H. ABACUS 2007-AC1 INVESTORS

1. IKB

52. IKB is a commercial bank headquartered in Dusseldorf, Germany. Historically, IKB specialized in lending to small and medium-sized companies. Beginning in and around 2002, IKB, for itself and as an advisor, was involved in the purchase of securitized assets referencing, or consisting of, consumer credit risk including RMBS CDOs backed by U.S. mid-and-subprime mortgages. IKB's former subsidiary, IKB Credit Asset Management GmbH, provided investment advisory services to various purchasing entities participating in a commercial

paper conduit known as the "Rhineland programme conduit."

53. The identity and experience of those involved in the selection of CDO portfolios was an important investment factor for IKB. In late 2006 IKB informed a GS&Co sales representative and Tourre that it was no longer comfortable investing in the liabilities of CDOs that did not utilize a collateral manager, meaning an independent third-party with knowledge of the U.S. housing market and expertise in analyzing RMBS. Tourre and GS&Co knew that ACA was a collateral manager likely to be acceptable to IKB.

54. In February, March and April 2007, GS&Co sent IKB copies of the ABACUS 2007-AC1 term sheet, flip book and offering memorandum, all of which represented that the RMBS portfolio had been selected by ACA and omitted any reference to Paulson, its role in selecting the reference portfolio and its adverse economic interests. Those representations and omissions were materially false and misleading because, unbeknownst to IKB, Paulson played a significant role in the collateral selection process and had financial interests in the transaction directly adverse to IKB. Neither GS&Co nor Tourre informed IKB of Paulson's participation in the collateral selection process and its adverse economic interests.

55. The first written marketing materials for ABACUS 2007-AC1 were distributed on February 15, 2007, when GS&Co emailed a preliminary term sheet and reference portfolio to the GS&Co sales representative covering IKB. Tourre was aware these materials would be delivered to IKB.

56. On February 19, 2007, the GS&Co sales representative forwarded the marketing materials to

IKB, explaining via email: "Attached are details of the ACA trade we spoke about with Fabrice [Tourre] in which you thought the AAAs would be interesting."

57. Tourre maintained direct and indirect contact with IKB in an effort to close the deal. This included a March 6, 2007 email to the GS&Co sales representative for IKB representing that, "This is a portfolio selected by ACA . . ." Tourre subsequently described the portfolio in an internal GS&Co email as having been "selected by ACA/Paulson."

58. ABACUS 2007-AC1 closed on or about April 26, 2007. IKB bought $50 million worth of Class A-1 notes at face value. The Class A-1 Notes paid a variable interest rate equal to LIBOR plus 85 basis points and were rated Aaa by Moody's Investors Services, Inc. ("Moody's") and AAA by Standard & Poor's Ratings & Services ("S&P"). IKB bought $100 million worth of Class A-2 Notes at face value. The Class A-2 Notes paid a variable interest rate equal to LIBOR plus 110 basis points and were rated Aaa by Moody's and AAA by S&P.

59. The fact that the portfolio had been selected by an independent third-party with experience and economic interests aligned with CDO investors was important to IKB. IKB would not have invested in the transaction had it known that Paulson played a significant role in the collateral selection process while intending to take a short position in ABACUS 2007-AC1. Among other things, knowledge of Paulson's role would have seriously undermined IKB's confidence in the portfolio selection process and led senior IKB personnel to oppose the transaction.

60. Within months of closing, ABACUS 2007-AC1's Class A-1 and A-2 Notes were nearly

worthless. IKB lost almost all of its $150 million investment. Most of this money was ultimately paid to Paulson in a series of transactions between GS&Co and Paulson.

2. ACA/ABN AMRO

61. ACA's parent company, ACA Capital Holdings, Inc. ("ACA Capital"), provided financial guaranty insurance on a variety of structured finance products including RMBS CDOs, through its wholly-owned subsidiary, ACA Financial Guaranty Corporation. On or about May 31, 2007, ACA Capital sold protection or "wrapped" the $909 million super senior tranche of ABACUS 2007-AC1, meaning that it assumed the credit risk associated with that portion of the capital structure via a CDS in exchange for premium payments of approximately 50 basis points per year.

62. ACA Capital was unaware of Paulson's short position in the transaction. It is unlikely that ACA Capital would have written protection on the super senior tranche if it had known that Paulson, which played an influential role in selecting the reference portfolio, had taken a significant short position instead of a long equity stake in ABACUS 2007-AC1.

63. The super senior transaction with ACA Capital was intermediated by ABN AMRO Bank N.V. ("ABN"), which was one of the largest banks in Europe during the relevant period. This meant that, through a series of CDS between ABN and Goldman and between ABN and ACA that netted ABN premium payments of approximately 17 basis points per year, ABN assumed the credit risk associated with the super senior portion of ABACUS 2007-AC1's capital structure in the event. ACA Capital was unable to pay.

64. GS&Co sent ABN copies of the ABACUS 2007-AC1 term sheet, flip book and offering memorandum, all of which represented that the RMBS portfolio had been selected by ACA and omitted any reference to Paulson's role in the collateral selection process and its adverse economic interest. Tourre also told ABN in emails that ACA had selected the portfolio. These representations and omissions were materially false and misleading because, unbeknownst to ABN, Paulson played a significant role in the collateral selection process and had a financial interest in the transaction that was adverse to ACA Capital and ABN.

65. At the end of 2007, ACA Capital was experiencing severe financial difficulties. In early 2008, ACA Capital entered into a global settlement agreement with its counterparties to effectively unwind approximately $69 billion worth of CDSs, approximately $26 billion of which were related to 2005-06 vintage subprime RMBS. ACA Capital is currently operating as a run-off financial guaranty insurance company.

66. In late 2007, ABN was acquired by a consortium of banks that included the Royal Bank of Scotland ("RBS"). On or about August 7, 2008, RBS unwound ABN's super senior position in ABACUS 2007-AC1 by paying GS&Co $840,909,090. Most of this money was subsequently paid by GS&Co to Paulson.

CLAIMS FOR RELIEF

FIRST CLAIM

Section 17(a) of the Securities Act

67. Paragraphs 1-66 are realleged and incorporated herein by reference.

68. GS&Co and Tourre each violated Section 17(a)(1), (2) and (3) of the Exchange Act [15 U.S.C. § 77q(a)(1), (2) & (3)].

69. As set forth above, Goldman and Tourre, in the offer or sale of securities or securities-based swap agreements, by the use of means or instruments of interstate commerce or by the mails, directly or indirectly (a) employed devices, schemes or artifices to defraud; (b) obtained money or property by means of untrue statements of material facts or omissions of material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or (c) engaged in transactions, practices or courses of business which operated or would operate as a fraud or deceit upon purchasers of securities.

70. GS&Co and Tourre knowingly, recklessly or negligently misrepresented in the term sheet, flip book and offering memorandum for ABACUS 2007-AC1 that the reference portfolio was selected by ACA without disclosing the significant role in the portfolio selection process played by Paulson, a hedge fund with financial interests in the transaction directly adverse to IKB, ACA Capital and ABN. GS&Co and Tourre also knowingly, recklessly or negligently misled ACA into believing that Paulson invested in the equity of ABACUS 2007-AC1 and, accordingly, that Paulson's interests in the collateral selection process were

closely aligned with ACA's when in reality their interests were sharply conflicting.

SECOND CLAIM

Section 10(b) and Rule 10-b(5) of the Exchange Act

71. Paragraphs 1-70 are realleged and incorporated herein by reference.

72. GS&Co and Tourre each violated Section 10(b) of the Exchange Act [15 U.S.C § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5].

73. As set forth above, GS&Co and Tourre, in connection with the purchase or sale of securities or securities-based swap agreements, by the use of means or instrumentalities of interstate commerce or of the mails, directly or indirectly (a) employed devices, schemes or artifices to defraud; (b) made untrue statements of material facts or omissions of material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or (c) engaged in transactions, practices or courses of business which operated or would operate as a fraud or deceit upon persons.

74. GS&Co and Tourre knowingly or recklessly misrepresented in the term sheet, flip book and offering memorandum for ABACUS 2007-AC1 that the reference portfolio was selected by ACA without disclosing the significant role in the portfolio selection process played by Paulson, a hedge fund with financial interests in the transaction adverse to UIKB, ACA Capital and ABN. GS&Co and Tourre also knowingly or recklessly misled ACA into believing that Paulson invested in the equity of ABACUS 2007-AC1 and,

accordingly, that Paulson's interests in the collateral selection process were closely aligned with ACA's when in reality their interests were sharply conflicting.

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court enter a judgment:

A. Finding that GS&Co and Tourre each violated the federal securities laws and the Commission rule alleged in this Complaint;

B. Permanently restraining and enjoining GS&Co and Tourre from violating Section 17(a) of the Securities Act [15 U.S.C. §77q(a)], Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Exchange Act Rule 10b-5 [17 C.F.R. § 240.10b-5];

C. Ordering GS&Co and Tourre to disgorge all illegal profits that they obtained as a result of their fraudulent misconduct, acts or courses of conduct described in this Complaint, and to pay prejudgment interest thereon;

D. Imposing civil monetary penalties on GS&Co and Tourre pursuant to Section 20(d)(2) of the Securities Act [15 U.S.C. § 77t (d)(2)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)]; and

E. Granting such equitable relief as may be appropriate or necessary for the benefit of investors pursuant to Section 21(d)(5) of the Exchange Act [15 U.S.C. § 78u(d)(5)] .

Dated: Washington, D.C.
April 16, 2010

Respectfully submitted,

/s/ ______________________________

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From:	Popov, Snejina
Sent:	Friday, April 16, 2010 1:09 PM
To:	Blankfein, Loyd; Cohn, Gary; Viniar, David; Rogers, John F.W.; van Praag. Lucas; Solomon, David (IB, 200W/41); Sherwood; Michael S; Evans, J. Michael; Forst, Ed
Cc:	gs-ir-30-cc
Subject:	GS and Peers: (After the Bell)
Attachments:	Picture (Device Independent Bitmap)

- GS down 13.1% to $160.70 and a P/B of 1.37x
- The peer set down 5.9%, pulling broader markets down 1.1%. Financials led markets sharply lower after federal regulators filed civil fraud charges against Goldman Sachs regarding alleged conflicts of interest in connection with CDO marketing. The news sent shock-waves into the market and introduced new layers of uncertainty in the potential direction of financial regulation. Market participants appear to be questioning whether the charges are an isolated event or the first in a series of many amid greater scrutiny of the credibility of the SEC. Incidentally, the allegations come as the Obama administration seeks greater regulation of the nation's banks, with many believing the announcement will likely hinder potential road blocks.
- Adding to the negativity, a report showed consumer sentiment fell from 73.6 in March to 69.5 in April, the lowest level in five months. The date is largely inconsistent with recent signs that Americans are beginning to spend more liberally

and a broader sense that a consumer-led recovery is gaining steam.

- MS down 6.4% to a P/B of 1.07x
- C down 7.5% to a P/B of 0.85x
- JPM down 4.6% to a P/B of 1.16x
- BAC down 5.1% to a P/B of 0.87x despite a return to profitability and better-than-expected 1Q10 results.

Ticker	Stock Price	Daily Δ ($)	Daily Δ (%)	P/B	GS P/B Premium	P/TB	GS P/TB premium/ (discount)
GS	$160.70	($24.22)	(13.1%)	1.37 x	NA	1.48 x	NA
MS	$29.16	($1.93)	(6.4%)	1.07 x	28%	1.35 x	10%
C	$4.56	($0.37)	(7.5%)	0.85 x	60%	1.10 x	35%
JPM	$45.55	($2.18)	(4.6%)	1.16 x	18%	1.70 x	-13%
BAC	$18.41	($0.99)	(5.1%)	0.87 x	57%	1.57 x	-6%
Peer Average (Banks/Brokers)			(5.9%)	0.99 x	39%	1.43 x	4%

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Snejina Popov
Investor Relations

Goldman Sachs

Goldman, Sachs & Co. and Fabrice Tourre

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SECURITIES AND EXCHANGE COMMISSION

Litigation Release No. 21489 / April 16, 2010

Securities and Exchange Commission v. Goldman, Sachs & Co. and Fabrice Tourre, 10 Civ, 3229 (B3). (S.D.N.Y. filed April 16, 2010)

The SEC Charges Goldman Sachs With Fraud In Connection With The Structuring And Marketing of A Synthetic CDO

The Securities and Exchange Commission today filed securities fraud charges against Goldman, Sachs & Co. ("GS&Co") and a GS&Co employee, Fabrice Tourre ("Tourre"), for making material misstatements and omissions in connection with a synthetic collateralized debt obligation ("CDO") GS&Co structured and marketed to investors. This synthetic CDO, ABACUS 2007-AC1, was tied to the performance of subprime residential mortgage-backed securities ("RMBS") and was structured and marketed in early 2007 when the United States housing market and the securities referencing it were beginning to show signs of distress. Synthetic CDOs like ABACUS 2007-AC1 contributed to the recent financial crisis by magnifying losses associated with the downturn in the United States housing market.

According to the Commission's complaint, the marketing materials for ABACUS 2007-AC1 — including the term sheet, flip book and offering memorandum for the CDO — all represented that the reference portfolio of RMB5 underlying the CDO was selected by ACA Management LLC ("ACA"), a third party with expertise in analyzing credit risk in RMBS.

Undisclosed in the marketing materials and unbeknownst to investors, a large hedge fund, Paulson & Co. Inc. (“Paulson”), with economic interests directly adverse to investors in the ABACUS 2007-AC1 CDO played a significant role in the portfolio selection process. After participating in the selection of the reference portfolio, Paulson effectively shorted the NABS portfolio it helped select by entering into credit default swaps (“CDS”) with GS&Co to buy protection on specific layers of the ABACUS 2007-AC1 capital structure. Given its financial short interest, Paulson had an economic incentive to choose RMBS that it expected to experience credit events in the near future. GS&Co did not disclose Paulson’s adverse economic interest or its role in the portfolio selection process in the term sheet, flip book, offering memorandum or other marketing materials.

The Commission alleges that Tourre was principally responsible for ABACUS 2007-AC1. According to the Commission’s complaint, Tourre devised the transaction, prepared the marketing materials and communicated directly with investors. Tourre is alleged to have known of Paulson’s undisclosed short interest and its role in the collateral selection process. He is also alleged to have misled ACA into believing that Paulson invested approximately $200 million in the equity of ABACUS 2007-AC1 (a long position) and, accordingly, that Paulson’s interests in the collateral section process were aligned with ACA’s when in reality Paulson’s interests were sharply conflicting. The deal closed on April 26, 2007. Paulson paid GS&Co approximately $15 million for structuring and marketing ABACUS 2007-AC1. By October 24, 2007, 83% of the RMBS in the ABACUS 2007-AC1 portfolio had been downgraded and 17% was on negative watch.

By January 29, 2008, 99% of the portfolio had allegedly been downgraded, Investors in the liabilities of ABACUS 2007-AC.1 are alleged to have lost over $1 billion. Paulson's opposite CDS positions yielded a profit of approximately $1 billion.

The Commission's complaint, which was filed in the United States District Court for the Southern District of New York, charges GS&Co and Tourre with violations of Section 17 (a) of the Securities Act of 1933, 15 U.S.C. §77q(a), Section 10(b) of the Securities Exchange Act of 1914, 15 U.S.C. §78j(b) and Exchange Act Rule 10b-5, §240.10b-5. The Commission seeks injunctive relief, disgorgement of profits, prejudgment interest and civil penalties from both defendants.

The Commission's investigation is continuing into the practices of investment banks and others that purchased and securitized pools of subprime mortgages and the resecuritized CDO market with a focus on products structured and marketed in late 2006 and early 2007 as the U.S. housing market was beginning to show signs of distress.

See Also: <u>SEC Complaint</u>

http://www.sec.gov/litigation/litreleases/2010/ir21489.htm

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REUTERS

BUSINESS NEWS

April 16, 2010 / 10:57 AM / 8 years ago
Goldman Sachs charged with fraud by SEC

Jonathan Stempel, Steve Eder

NEW YORK (Reuters) - Goldman Sachs Group Inc was charged with fraud by the U.S. Securities and Exchange Commission over its marketing of a subprime mortgage product, igniting a battle between Wall Street's most powerful bank and the nation's top securities regulator.

The civil lawsuit is the biggest crisis in years for a company that faced criticism over its pay and business practices after emerging from the global financial meltdown as Wall Street's most influential bank.

It may also make it more difficult for the industry to beat back calls for reform as lawmakers in Washington debate an overhaul of financial regulations.

Goldman called the lawsuit "completely unfounded," adding, "We did not structure a portfolio that was designed to lose money."

The lawsuit puts Goldman Chief Executive Lloyd Blankfein further on the defensive after he told the federal Financial Crisis Inquiry Commission in January that the bank packaged complex debt, while also betting against the debt, because clients had the appetite.

"We are not a fiduciary," he said.

The case also involves John Paulson, a hedge fund investor whose firm Paulson & Co made billions of dollars by betting the nation's housing market would crash. This included an estimated $1 billion from the transaction detailed in the lawsuit, which the SEC said cost other investors more than $1 billion. Paulson was not charged.

Fabrice Tourre, a Goldman vice president whom the SEC said was mainly responsible for creating the questionable mortgage product, known as ABACUS, was charged with fraud.

Goldman shares slid 12.8 percent on Friday, closing down $23.57 at $160.70 on the New York Stock Exchange. The decline wiped out more than $12 billion of market value, and trading volume topped 100 million shares, Reuters data show.

The news dragged down broad U.S. equity indexes, which fell more than 1 percent. The perceived risk of owning Goldman debt, as measured by credit default swaps, increased. Treasury prices rose as investors sought safe-haven government debt.

MORE SEVERE THAN EXPECTED

"These charges are far more severe than anyone had imagined," and suggest Goldman teamed with "the leading short-seller in the industry to design a portfolio of securities that would crash," said John Coffee, a securities law professor at Columbia Law School in New York.

"The greatest penalty for Goldman is not the financial damages – Goldman is enormously wealthy – but the reputational damage," he said, adding that "it's not impossible" to contemplate that the case could lead to criminal charges. Coffee spoke on Reuters Insider.

Goldman vowed to defend itself.

"The SEC's charges are completely unfounded in law and fact," it said. "We will vigorously contest them and defend the firm and its reputation."

E-mails from former Washington Mutual Inc CEO Kerry Killinger read aloud during a congressional hearing this week illustrated clients' concerns about working with Goldman.

In 2007, Killinger discussed hiring Goldman or another investment bank to help Washington Mutual find ways to reduce its credit risk or raise new capital, according to one of the e-mails, which Michigan Democratic Sen Carl Levin read during the hearing.

"I don't trust Goldie on this," Levin quoted one of Killinger's e-mails as saying. "They are smart, but this is swimming with the sharks. They were shorting mortgages big-time while they were giving (Countrywide Financial Corp) advice."

The SEC lawsuit announced on Friday concerns ABACUS, a synthetic collateralized debt obligation that hinged on the performance of subprime residential mortgage-backed securities, and which the regulator said Goldman structured and marketed.

According to the SEC, Goldman did not tell investors "vital information" about ABACUS, including that Paulson & Co was involved in choosing which securities would be part of the portfolio.

The SEC also alleged that Paulson took a short position against the CDO in a bet that its value would fall.

In a statement, Paulson & Co said it did buy credit protection from Goldman on securities issued in the ABACUS program, but did not market the product.

Tourre was not immediately available for comment.

Goldman had not disclosed that the SEC was considering a lawsuit but had known charges were possible and had urged the SEC not to file them, people familiar with the situation said on Friday. The sources requested anonymity because the probe was not public.

To better understand CDOs, the SEC in 2008 approached some hedge funds, including Paulson & Co, whose investment Paulo Pellegrini was among those to talk with the regulator.

By betting against subprime mortgage-related debt, Pellegrini helped Paulson's firm earn an estimated $15 billion in 2007. Pellegrini last year left to start his own firm.

COMING OUT SWINGING

The lawsuit is a regulatory and public relations nightmare for Blankfein, who has spent 18 months fending off complaints that Goldman has been an unfair beneficiary of taxpayer bailouts of Wall Street.

Blankfein became chief executive less than a year before the product challenged by the SEC was created.

"This could be the beginning of a period where you have a regulatory cloud over Goldman Sachs, and perhaps even the entire investment banking industry," said Hank Smith, chief investment officer at Haverford Trust Co in Philadelphia.

John Paulson is not related to Henry "Hank" Paulson, who was Blankfein's predecessor as Goldman chief executive and later become U.S. Treasury secretary.

The SEC lawsuit represents an aggressive expansion of regulatory efforts to hold people and companies responsible for the nation's financial crises.

It could help the regulator rehabilitate its reputation after missing other high-profile cases, including Bernard Madoff's Ponzi scheme.

"The SEC has come out swinging," said Cary Leahey, senior managing director of Decision Economics in New York.

Robert Khuzami, head of the SEC's enforcement division, said John Paulson was not charged because it was Goldman that made misrepresentations to investors, not Paulson.

Still, Khuzami called Paulson's firm "a hedge fund that had a particular interest in the securities performing poorly."

MORE LAWSUITS TO COME?

It is unlikely that criminal charges will be brought, a person close to the matter said. Representatives for the Justice Department declined to comment.

Yet the lawsuit is widely expected to spur other lawsuits, and is "probably the first of several," according to Doug Kass, president of hedge fund Seabreeze Partners Management.

"Regulators and plaintiffs' lawyers are going to be looking at other deals, to what kind of conflicts Goldman has," said Jacob Zamansky, a lawyer who represents investors in securities fraud lawsuits.

"I've been contacted by Goldman customers to bring lawsuits to recover their losses," he added. "With the SEC bringing fraud charges it's going to expose what's behind the curtain."

E-MAIL TRAIL

According to the SEC, Goldman marketing materials showed that a third party, ACA Management LLC, chose the securities underlying ABACUS, without revealing Paulson's involvement.

The SEC complaint quotes extensively from internal e-mails and memos, noting that in early 2007 it had become difficult to market CDOs tied to mortgage-backed securities.

It quoted a January 23, 2007, e-mail from Tourre to a friend as saying: "The whole building is about to collapse anytime now . . . Only potential survivor, the fabulous Fab . . . standing in the middle of all these complex, highly leveraged, exotic trades he created without necessarily understanding all of the implications of those monstrosities!!!"

Another e-mail, to Tourre from the head of Goldman's structured product correlation trading desk, complained: "The CDO biz is dead we don't have a lot of time left."

INDEPENDENCE MATTERS TO CLIENTS

Other communications detail the importance of hiring ACA.

The SEC said Goldman reached out to German bank IKB to buy securities that Paulson was selling, knowing it would buy only securities selected by an independent asset manager.

"We expect the strong brand-name of ACA as well as our market-leading position in synthetic CDOs of structured products to result in a successful offering," a March 12, 2007, Goldman e-mail said.

IKB ultimately took on exposure to ABACUS, as did the Dutch bank ABN Amro Holding NV.

The German government ultimately bailed out IKB in the summer of 2007, in part because of the bank's investments, while lenders that eventually bought much of ABN Amro were also subjected to their own government bailouts.

In a statement after U.S. markets closed, Goldman said it lost more than $90 million on the transaction, six times the $15 million fee it received, and provided "extensive disclosure" on the securities involved.

It also said it never represented to ACA Capital Management, which invested $951 million in the transaction, that Paulson was going to be a "long" investor, meaning that Paulson was betting the securities would gain in value.

Paulson & Co paid Goldman $15 million to structure and market the ABACUS CDO, which closed on April 26, 2007, the SEC said. Little more than nine months later, 99 percent of the portfolio had been downgraded, the SEC said.

Janet Tavakoli, president of Tavakoli Structured Finance Inc in Chicago and author of a book on synthetic CDOs, said it may have been common on Wall Street for hedge funds to play big roles in picking mortgage-backed securities for use in CDOs.

"Many investors were not aware of how disadvantaged they were by these CDO structures," she said.

WASHINGTON IMPACT

The charges are expected to fuel anti-Wall Street sentiment on Capitol Hill where sweeping financial industry reforms are expected to soon arrive on the Senate floor for a vote.

A Democratic bill, strongly supported by President Barack Obama, would slap new restraints on major banks, likely curtailing their opportunities for profit and revenue growth.

Similar legislation was approved in the House of Representatives in December. Analysts believe a bill could be signed into law by Obama by mid-year.

"Banks were getting their mojo back, successfully fighting the regulatory reform bill," said James Ellman, president of Seacliff Capital in San Francisco. "Clearly, such malfeasance could help get the bill to go through."

Goldman in 2008 won a $5 billion investment from Warren Buffett's Berkshire Hathaway Inc.

Last month, Buffett praised Goldman as a "very, very strong, well-run business," and said of Blankfein, "You cannot find a better manager."

Buffett had no immediate comment, his assistant Carrie Kizer said.

The SEC lawsuit was assigned to U.S. District Judge Barbara Jones, who was appointed to the bench in 1995 by President Bill Clinton. She presided over the 2005 criminal trial of former WorldCom Inc Chief Executive Bernard Ebbers over an $11 billion accounting fraud at the phone company.

The case is SEC v. Goldman Sachs & Co et al, U.S. District Court, Southern District of New York, No. 10-03229. (Reporting by Jennifer Ablan, Maria Aspan, Clare Baldwin, Karen Brettell, Jeffrey Cane, Elinor Comlay, Kevin Drawbaugh, Steve Eder, Ellen Freilich, Burton Frierson, David Gaffen, Joseph A. Giannone, Matthew Goldstein, Svea Herbst-Bayliss, Ed Krudy, Herb Lash, Grant McCool, Jeremy Pelofsky, Christian Plumb, Aaron Pressman, Leah Schnurr, Jonathan

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CHICAGO TRIBUNE

April 17, 2010 Saturday
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SECTION: NEWS; ZONE C; Pg. 8

LENGTH: 418 words

HEADLINE: SEC lawsuit alleges Goldman Sachs fraud

BYLINE: By Nathaniel Popper, TRIBUNE NEWSPAPERS Tribune Newspapers reporter Tom Petruno contributed to this report.

DATELINE: NEW YORK

BODY:

In one of the most dramatic cases emanating from the global financial crisis, federal regulators accused investment banking powerhouse Goldman Sachs Group Inc. of fraud for its role in issuing securities that were at the heart of the financial crisis.

The civil lawsuit, filed Friday by the Securities and Exchange Commission, sent a shudder through Wall Street as investors girded for possible suits against other institutions. Stocks fell sharply after the announcement, led by financial shares, with Goldman stock down nearly 13 percent.

The charges relate to so-called collateralized debt obligations, complex securities tied to the performance of subprime mortgages, that Goldman created in 2007 near the end of the housing boom.

The value of the securities plunged in the mortgage meltdown that began later that year, helping to set off the global financial crisis.

At the heart of the case is the SEC's claim that Goldman duped investors by failing to give them the entire story about the deal, and who really stood to benefit.

The lawsuit alleges Goldman did not tell investors that the products were based on a portfolio of mortgage bonds selected by a hedge fund. Goldman subsequently helped the hedge fund, Paulson & Co., place bets against the same bond portfolio, the suit said.

"The product was new and complex, but the deception and conflicts are old and simple," Robert Khuzami, the SEC's enforcement chief, said in a statement. "Goldman wrongly permitted a client that was betting against the mortgage market to heavily influence which mortgage securities to include in an investment portfolio, while telling other investors that the securities were selected by an independent, objective third party."

Paulson, which made a number of such bets, made billions of dollars as the subprime home-loan market collapsed in a wave of borrower defaults. It is not part of the SEC's case.

Goldman, meanwhile, denied any wrongdoing.

"The SEC's charges are completely unfounded in law and fact, and we will vigorously contest them and defend the firm and its reputation," Goldman said in a statement

In the wake of the lawsuit, President Barack Obama said he would veto any bill to overhaul financial regulations that doesn't include new rules on derivatives.

Obama, facing stiffening Republican and industry opposition to his proposal, said the government must act to prevent another financial crisis, and new rules should include regulating the $605 trillion over-the-counter derivatives market.

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THE ASSOCIATED PRESS

April 18, 2010 Sunday 09:28 PM GMT

SECTION: BUSINESS NEWS

LENGTH: 1214 words

HEADLINE: Fraud charge deals big blow to Goldman's image

BYLINE: By STEVENSON JACOBS, AP Business Writer

DATELINE: NEW YORK

BODY:

While Goldman Sachs contends with the government's civil fraud charges, an equally serious problem looms: a damaged reputation that may cost it clients.

The Securities and Exchange Commission's bombshell civil fraud charge against Goldman has tarnished the Wall Street bank's already bruised image, analysts say. It could also hurt its ability to do business in an industry based largely on trust.

Damage from the case could hit other big banks as well. The SEC charges are expected to help the Obama administration as it seeks to more tightly police lucrative investment banking activities.

Goldman has denied the SEC's allegation that it sold risky mortgage investments without telling buyers that the securities were crafted in part by a billionaire hedge fund manager who was betting on them to fail. A 31-year-old Goldman employee is also accused in the civil suit that was announced Friday.

The charges could result in fines and restitution of more than $700 million, predicted Brad Hintz, an analyst at Sanford Bernstein. Yet, even if Goldman beats the charge, the hit to its reputation could carry a greater cost.

The company, founded in 1869, grew from a one-man outfit trading promissory notes in New York to the world's most powerful, most profitable and arguably most envied securities and investment firm. From its 43-story glass-and-steel headquarters in Lower Manhattan, Goldman oversees a financial empire that spans more than 30 countries and includes more than 30,000 employees.

It has long attracted some of the world's best and brightest. Some have gone on to lofty careers in public life, enhancing the firm's aura of mystique and influence. Goldman alumni include former Treasury Secretaries Henry Paulson and Robert Rubin and former New Jersey Gov. Jon Corzine.

In its corporate profile, the company says its culture distinguishes it from other firms and "helps to make us a magnet for talent." That culture is summed up in the firm's "14 Business Principles," which preach an almost militant philosophy of putting the client before the firm.

Now, it's that very philosophy that has been questioned by the government.

So far, no Goldman clients have publicly condemned the bank's alleged actions. But the negative publicity and regulatory scrutiny could cause some to distance themselves, said Mark T. Williams, a professor of finance and economics at Boston University.

Goldman earned a record $4.79 billion during the fourth quarter of last year and is expected to report blowout first-quarter results on Tuesday. A big chunk of its profits are from fee-based client businesses, such as investment advising, underwriting securities and brokering billion-dollar mergers.

"Goldman can really only truly be effective in the marketplace if it maintains a strong reputation," Williams said.

Morgan Stanley, the No. 2 U.S. investment bank after Goldman, could be in a position to poach some Goldman clients, which include hedge funds, pension funds and other big institutional investors. Overseas, European rivals such as Deutsche Bank AG and UBS could benefit.

Investors are already betting the legal troubles will hurt Goldman's finances. The company's shares plunged 13 percent after the charges were announced Friday, erasing a staggering $12.5 billion in market value.

"Reputation risk is the biggest issue in our view," Citigroup analyst Keith Horowitz wrote in a note to clients. He predicted the fraud case won't be a "life-threatening issue" but that it "clearly seems like a black eye for Goldman."

It's not the first. The company came under criticism for receiving billions in bailout money that the government funneled into crippled insurer American International Group Inc. at the height of the financial crisis in 2008. Goldman was owed the money, but critics argued it should've been treated like other creditors and be forced to accept less.

Goldman CEO Lloyd Blankfein angered the bank's critics last year after The Times of London quoted him as saying he was "doing God's work" running the firm and handing out big employee bonuses. Blankfein himself got a $9 million stock bonus for 2009.

Mishaps like those have been surprising given how much attention Goldman pays to its image. "Our clients' interests always come first," the company says on its website under the heading, "Goldman Sachs Business Principle No. 1."

It's a sales pitch that few Wall Street firms always live up to. Some analysts blame that on a shift in the industry's business model from traditional investment banking to one that focuses on making big bets for itself or clients.

That shift culminated in the rise of Blankfein, a former commodities trader, to the position of CEO in 2003. Today, trading accounts for nearly 70 percent of Goldman's revenue. Most of that trading is done on behalf of clients, though Goldman generates about 10 percent of its revenue by trading for itself.

The heavy reliance on trading and Goldman's peerless performance have left the firm open to criticism that it uses its market knowledge to game the system to benefit itself and a select group of clients.

The SEC charges seemingly support that assertion. Fabrice Tourre, the 31-year-old Goldman executive accused of shepherding the deal in question, boasted about the "exotic trades" he created "without necessarily understanding all of the implications of those monstrosities!!!," according to the SEC complaint.

In another e-mail, he describes as "surreal" a meeting between his hedge fund client and another firm that allegedly wasn't told that the bundle of securities it was buying were chosen with input from a third party who was betting they would fail.

"Once upon a time, Wall Street firm protected clients," said Christopher Whalen, managing director of financial research firm Institutional Risk Analytics. "This litigation exposes the cynical, savage culture of Wall Street that allows a dealer to commit fraud on one customer to benefit another."

In a lengthy rebuttal to the SEC charges Friday, Goldman insisted it was a middleman in the transaction and did nothing wrong by not disclosing bearish bets against the pool by Paulson & Co., a major hedge fund led by billionaire investor John Paulson. Goldman said it lost $90 million on the deal.

The SEC said Goldman had a duty to inform buyers of the mortgage investments that Paulson had played a major role in choosing the securities that went into the derivatives product and then bet that they would go bust.

Derivatives are complex financial products whose value is based on an underlying asset like mortgages or other types of debt. They're not traded on a public exchange, allowing firms like Goldman to generate fees by brokering deals between buyers and sellers.

The charges strengthen the government's case for increased regulation of derivatives like those Goldman is accused of using, analysts said.

Regardless, Goldman's ability to weather the storm should not be discounted, said Janet Tavakoli, president of Tavakoli Structured Finance, a Chicago consulting firm.

"The benefits of the crisis have so far swamped the reputation risks for Goldman," she said.

"If anything," she added, "they may wind up getting more customers if people can't avoid doing business with them."

AP Business Writer Chip Cutter contributed to this report from New York.

THE WALL STREET JOURNAL

Wednesday, April 21, 2010

Where's the Goldman Sachs That I Used to Know

By James B. Stewart

"Surreal" was the word Goldman Sachs Group's Fabrice Tourre used to describe a meeting in which the firm of hedge-fund billionaire John Paulson discussed with an investor a portfolio of mortgage-backed securities it eventually planned to short. That Goldman Sachs, a name once synonymous with professionalism and integrity, now stands accused by the Securities and Exchange Commission of fraud also might be deemed surreal.

It's hard to imagine the damage that these developments have done already to Goldman Sach's reputation. The company has always maintained a public position that business of investment backing depends on trust, integrity and putting clients' interests first.

Whether those clients remain loyal to Goldman, and whether the firm can attract new ones, remains to be seen. Investors' reaction to the news was swift and negative: Goldman shares dropped down 13% Friday after the SEC filed its suit. Goldman says it is innocent and will fight the accusations. The bank deserves its day in court, and legal experts have said the SEC faces a tough task in proving the company misled investors about how its complex investment vehicles were constructed. Given the public anger at Wall Street, and the criticism of the SEC's failure to regulate more effectively before the financial crisis struck, it's worth considering that Goldman makes an enticing political target, regardless of the suit's merits.

Goldman hasn't disputed the basic facts in the SEC's narrative: (1) that the company allowed its client Mr. Paulson, who famously made billions betting that subprime mortgages would default, to play a role in the selection of a portfolio of the worst imaginable subprime mortgages that would be packaged into a collateralized debt obligation, and (2) that the bank failed to disclose to clients to whom it sold those CDOs that it had, in effect, let the fox into the henhouse. Goldman claims its sophisticated clients wouldn't have cared about such information or considered it important, but if that's the case, why did Goldman conceal it? Goldman collected millions of dollars in fees from Mr. Paulson, who bet against the doomed securities, and from the clients who invested in them.

For many years, I was a Goldman Sachs shareholder. I bought shares soon after they first went public in 1999 and held them until I sold them last year, as I reported in this column. I owned them and recommended them on several occasions because I believed in Goldman's integrity and the culture that fostered it. I have had friends who work at Goldman or who have worked there. To me, they embody the best of Wall Street. They're smart, well-educated, thoughtful, professional and hard-working. This is the Goldman I invested in, not the Goldman alleged to have collaborated with someone like Mr. Paulson to hoodwink investors. I'm not even that concerned about whether the Paulson deal passes legal muster. To me, it fails the higher standards of honesty and professionalism that Goldman once embodied and urgently needs to restore. Then, and only then, would I want to own Goldman shares again.

In its first-quarter earnings conference call Tuesday morning, the company continued to deny wrongdoing and cited its net losses on the deal. Greg Palm, the firm's general counsel, said Goldman "would never intentionally mislead anyone," and that the company "would never condone inappropriate behavior."

To regain investor trust, Goldman must abandon conventional public relations and legal strategies that call for an all-out defense. It should stop saying it will fight the charges aggressively and that the SEC's suit is "completely unfounded." No matter how wronged Goldman officials now feel, they must put those feelings aside and view this matter from the perspective of clients, investors, politicians and the public. Goldman's mantra should be cooperation, not defiance.

When an institution depends on trust and is accused of wrongdoing, it needs to get ahead of the investigators. It needs to learn the facts, share them with the public, impose accountability on its employees, and take any steps necessary to remedy the problem and restore trust. I say this as someone who has written about wrongdoing on Wall Street for years and watched once venerable firms like Kidder Peabody and Drexel Burnham Lambert ignore such advice and pass into oblivion.

This needn't be Goldman's fate. It's already unfortunate that we've learned about the Paulson deals from the SEC and the press rather than from Goldman itself, especially because the firm says it's been on notice since July that it might be sued. But it isn't too late for the firm to move boldly to restore trust. Goldman needs to explain:

▪ Why was a firm like Mr. Paulson's allowed to choose the securities in the CDO it was planning to bet against? Although Mr. Paulson's firm may have been smart to bet against subprime mortgages, this deal was like shooting fish in a barrel. Who else gets this kind of access, what does Goldman receive in return, and are their roles disclosed? (Though Mr. Paulson hasn't been accused of any wrongdoing it would be interesting to know how much money from the Troubled Asset Relief Program paid to American International Group, Goldman and others ended up going to him.)

■ Who at Goldman was responsible for giving Mr. Paulson such extraordinary access and then failing to disclose it? Surely it wasn't Mr. Tourre, the 31-year-old Stanford graduate named as a defendant in the SEC suit. Who did he report to? What was the hierarchy of oversight? In other words, where does the buck stop?

■ Legal issues aside, does Goldman really believe this deal needs its own standards of integrity, fairness and professionalism? The notion that purchasers of the securities wouldn't care about Mr. Paulson's role already fails the common-sense test. Such an argument would be far more persuasive if it came from the clients who bought them rather than Goldman. And it's no excuse that other firms were carrying out similar deals with comparable disclosure.

■ If Goldman concludes such a deal didn't meet its standards, it needs to acknowledge that and take whatever steps are necessary to prevent it from happening again. Someone has to be responsible and held accountable, perhaps even a highly valued and revered high-level official. Goldman needs to do this before it is forced to do so by a court, regulators, or Congress. This will be painful. It takes courage, objectivity, vision, and perhaps most of all, humility.

■ How will Goldman prevent such conflicts in the future? What is it doing internally to restore a culture of integrity? If Mr. Tourre or any other employee thought he was caught in a "surreal" situation, to whom could he take such concerns and get a fair hearing?

■ The SEC suit isn't Goldman's only potential scandal. The Wall Street Journal reported last week that Goldman director Rajat Gupta is being investigated as part of the sprawling Galleon insider-trading investigation. In the article, Goldman declined to comment on whether Mr. Gupta informed the company about having received a notice from prosecutors. What does Goldman know about possible leaks of inside information? Why, when Mr. Gupta told Goldman in March he wouldn't be standing for re-election, did Goldman Chief executive Lloyd Blankfein issue a public statement lavishing praise for his service? And why, for that matter, wasn't Mr. Gupta asked to resign immediately? Mr. Gupta hasn't been accused of wrongdoing, and Goldman is right not to prejudge him. But that doesn't mean Goldman should ignore the evidence or that someone under investigation is entitled to a board seat.

■ Are there other investigations we should know about?

These may well be isolated incidents, confined to a few individuals, their timing an unfortunate coincidence. If so, Goldman has all the more reason to get ahead of the scandal, get the facts and disclose them. It may require swallowing some pride and suffering some criticism. It's also the right thing to do.

THE WALL STREET JOURNAL

Friday, April 30, 2010 – Vol CCLV No. 100

Criminal Probe Looks Into Goldman Trading

By Susan Pulliam And Evan Perez

Federal prosecutors are conducting a criminal investigation into whether Goldman Sachs Group Inc. or its employees committed securities fraud in connection with its mortgage trading, people familiar with the probe say.

The investigation from the Manhattan U.S. Attorney's Office, which is at a preliminary stage, stemmed from a referral from the Securities and Exchange Commission, these people say. The SEC recently filed civil securities-fraud charges against the big Wall Street firm and a trader in its mortgage group. Goldman and the trader say they have done nothing wrong and are fighting the civil charges.

Prosecutors haven't determined whether they will bring charges in the case, say the people familiar with the matter. Many criminal investigations are launched that never result in any charges.

The criminal probe raises the stakes for Goldman, Wall Street's most powerful firm. The investigation is centered on different evidence than the SEC's civil case, the people say. It couldn't be determined which Goldman deals are being scrutinized in the criminal investigation.

A spokesperson for the Manhattan U.S. Attorney's office declined to comment. Goldman declined to comment.

Goldman shares fell 2.6% in after-hours trading to $156.08 after The Wall Street Journal reported the news of the investigation. At the 4 p.m. market close, Goldman shares rose 2.1%.

The development comes amid public calls for more Wall Street accountability for the industry's role in the financial crisis. Though there are multiple ongoing criminal and civil investigations, no Wall Street executives connected with the meltdown have been convicted of criminal charges. During congressional hearings this week into Goldman's role in the crisis, legislators grilled Goldman executives for nearly 11 hours.

The SEC and Justice Department often coordinate their actions on investigations. The probe underscores heightened efforts by the Manhattan U.S. Attorney's office in prosecuting white collar and Wall Street crime. It is in the midst of pursuing the largest insider-trading case in a generation, charging 21 individuals and negotiating 12 guilty pleas in that matter.

But the Goldman probe presents a significant challenge for the government. Prosecutors in the Brooklyn office of the U.S. Attorney last year lost a high-profile fraud case against two former Bear Stearns Cos. executives, in the first major criminal case linked to the financial meltdown.

Prosecutors had accused the Bear Stearns employees of lying to investors in 2007 about the health of two funds that eventually collapsed. The case centered on what the government viewed as incriminating emails indicating the traders knew the mortgage marked would fall but didn't disclose that view to investors.

To bring any criminal charges in the Goldman matter, prosecutors would need to believe they had gathered evidence that showed that the film or its employees knowingly committed fraud in their mortgage business. Proving such intent to break the law typically is the toughest hurdle for prosecutors to clear.

Another stumbling block: Such financial cases can be highly complex. Few outside of Wall Street understand arcane products such as collateralized debt obligations, the pools of mortgage-related holdings at the heart of the SEC civil case against Goldman.

On April 16, the SEC charged Goldman and an employee, Fabrice Tourre, with securities fraud in a civil suit relating to mortgage transaction known as Abacus 2007-ACI, the deal the government said was designed to fail. The SEC alleged that Goldman duped its clients by failing to disclose that hedge fund Paulson & Co. not only helped select the mortgages included in the deal but also bet against the transaction. Both Goldman and Mr. Tourre have denied wrongdoing.

Even the SEC's case, which is subject to a lesser standard of proof than a criminal case, is viewed as a challenge for regulators. The SEC's commissioners were split 3-2 along party lines on whether the agency should bring a case.

In battling the SEC charges, Goldman says its investors were sophisticated and knew the underlying securities they were buying. Goldman says it wasn't required to disclose who provided input into the deal or the views of its clients in the transaction.

The congressional hearing involved numerous other mortgage deals Goldman arranged in 2006 and 2007. Lawmakers criticized Goldman and its executives for allegedly stacking the deck against clients during the market meltdown in 2007. Some of the emails released by regulators, lawmakers and Goldman suggest a callous attitude at Goldman toward the risks involved in some of the mortgage deals, including one in which an employee referred to a mortgage transaction the firm sold to investors as a "sh---y" deal.

Over the years, the government has been reluctant to criminally charge financial firms with wrongdoing because the charge itself can cause a business to implode. Some investing clients can't or won't trade with a firm facing such a taint. Indeed, in the more than two-century history of the U.S. financial markets, no major financial firm has survived criminal charges. Securities firms E.F. Hutton & Co. and Drexel Burnham Lambert Inc. crumbled after being indicted in the 1980s. In 2002 Arthur Andersen LLP went bankrupt after it was convicted of obstruction of justice for its role in covering up an investigation into Enron Corp. The conviction was later overturned by the Supreme Court.

In recent years, some financial firms have agreed to "deferred prosecutions," in which they agree to a probationary period for which they won't commit any future wrongdoing.

That's what Prudential Securities Inc. did in 1994 when that securities firm faced criminal charges that it misled investors about the risks and rewards of limited-partnership investments.

–Susanne Craig contributed to this article.

From: Libstag, Gwen (FIN 200W41)

Sent: Friday, May 21, 2010 2:47 PM

To: Cohn. Gary [EO] Viniar, David;Stecher, Esta [GSBankUSA]; Rogers, John F.W. [EO]; Solomon, David [IBD]; Dyal, Gordon [IBD]; Scherr, Stephen [IBD]; Schwartz, Harvey [Fin]; Heller, David B [Sec Div]; Eisler, Ed [Sec Div]; Sherwood, Michael S; Cohen, Alan (AM-NY) [Compl]; Weinberg, John S. [IBD]

Subject: In case you somehow missed this one

- May 21, 2010, 11:53 AM GMT

How Goldman Gets Its Premium Back

Top of Form 1

Search The Source

- By Robert Armstrong and Gregory J. Milman

For the first time since 2003, Goldman Sachs trades at a price/tangible book discount to both JP Morgan Chase and Morgan Stanley. When the SEC is suing you and Congress is grilling you, investors simply steer clear of your stock. That's the common explanation. [Read our GS coverage here.]

But there is another possibility: that the premium has dissolved because the market is worried, not about lawsuits or politics, but about Goldman's core business.

The Abacus affair has highlighted the conflicts intrinsic to the investment banking business. But historically Goldman has managed those conflicts well. Moreover, the conflicts in the Abacus deal at the center or the SEC's case have nothing to do with trading priorities versus I-banking responsibilities — the tension usually cited in discussions of Goldman. The conflicts in the creation of the now-notorious synthetic CDOs were all on the trading side of the business.

The issue is more subtle than that. To see that, let's play a quick game of Can You Spot the Conflict?

Which of the following conflicts is nothing to worry about, in a gray area, or beyond the pale?

1. Bank makes a market in a company's securities while its prop desk is net short those securities.

2. Bank uses information about its clients' overall trading activities to make prop trading decisions.

3. Bank makes a market in mortgage securities issued by financial institution while its prop desk is net short that institution's shares.

4. Bank acts as adviser to mortgage company while its prop desk is net short mortgages.

5. Bank does advisory work for a client while its prop desk is short that client's shares.

6. Bank sells and supports an IPO or other equity or debt issue recognized to be very low quality.

7. Bank designs and sells structured mortgage security product while it is net short against the mortgage market and/or against buyers of the structured product.

8. Bank designs and sells hyper-leveraged synthetic CDO product while:

   a. believing at the management level that the mortgage market is ready to crack;

b. knowing the short party is more sophisticated than the long; and/or

c. there is more money to be made in the long run from the relationship with short party than from the long.

9. Bank's prop desk is net short a security while an analyst has a buy recommendation on it.

10. Bank uses inside information gained though client relationships to take short/long positions on that client's shares.

A good argument can be made that 1 and 2 are not problematic while 9 and 10 are out of bounds.

If you believe it is difficult, if not impossible, to separate flow and prop trading and that major banks cannot compete in advisory services without a sales and trading operation, the conflicts in scenarios 3 through 7 are inherent to the business and simply have to be managed.

As a group, 6 through 8 are particularly important. More than the other cases, a bank is benefiting from its own role as a financial counselor to trade for its own account or earn a fee. These three cases carry the greatest risk of serious conflicts, tainted advice and reputational harm. Banks that push the boundaries in these kinds of cases are giving all their advisory customers reason to worry.

Of course, scenario 8 is based on <u>Abacus</u>. Whatever the true facts are in Goldman's case, the business of constructing a synthetic CDO in a volatile market, shuttling between the counterparties to create the customized product, is riddled with potential conflicts.

This territory is especially dangerous for Goldman because of the perception that it is an elite adviser and an elite trader that can do both simultaneously while managing the conflicts to the satisfaction of its clients. That's why its stock carries a premium to its peers in bull markets.

Conversely, evidence of poorly managed conflicts is especially dangerous to Goldman. Some damage has already been done.

"If I'm a corporate treasurer would I do a debt underwriting with Goldman right now? I might say it's not worth the hassle of trying to explain to a board of directors or irate shareholders or my boss," says Sanford C. Bernstein and Co. analyst Brad Hintz.

Goldman will always play in gray areas — that's the nature of the modern I-bank — but everyone can tell dark gray from light gray.

To regain its valuation premium, Goldman must steer back to the light side.

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Managing Director
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FINANCIAL TIMES

Thursday June 10, 2010

US Regulators step up probe of second Goldman mortgage deal

CDO was not part of charges filed in April

By Francesco Guerrera, Justin Baer and Greg Farrell in New York

The US Securities and Exchange Commission has stepped up its inquiries into a complex mortgage-backed deal by Goldman Sachs that was not part of the civil fraud charges filed against the bank in April, according to people close to the matter.

SEC interest in Hudson Mezzanine Funding, a $2bn collaterised debt obligation, comes amid settlement talks with Goldman over accusations that the bank defrauded investors in Abacus, a similar CDO. Goldman has denied the SEC's complaint.

People familiar with the matter said that in recent weeks the SEC had been gathering information on Hudson Mezzanine, which featured prominently in an 11-hour grilling of Goldman's executives in the US Senate in April. The SEC and Goldman declined to comment.

The inquiry into Hudson Mezzanine is part of a wider investigation into the CDO activities of Wall Street banks. People close to the situation said the probe was preliminary and there was no certainty that it would lead to additional actions against Goldman.

The bank created and sold Hudson Mezzanine, which contained residential mortgage-backed securities from its own balance sheet, in late 2006.

In an internal e-mail unearthed by the Senate investigation, a Goldman employee said a potential investor in the CDO was “too smart to buy this kind of junk”.

Goldman went “short” on Hudson Mezzanine, buying protection on the entire value of the CDO, according to internal documents. Less than 18 months later, as the US housing bubble burst, Hudson Mezzanine’s credit rating had plunged to junk status, causing losses for investors and enabling Goldman to collect on the insurance.

Legal experts said that inquiries into Hudson Mezzanine were likely to focus on whether Goldman provided investors with adequate disclosure. In a marketing document, Goldman stated its interests were “aligned” with investors because it would buy equity in the CDO. In legal disclaimers, Goldman also said it would buy protection on the security, but it did not specify how much.

Carl Levin, the senator who chairs the sub-committee investigating Wall Street’s actions during the crisis, seized on the “junk” reference repeatedly during the hearing when questioning Lloyd Blankfein and other Goldman executives.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

10-CV-3229 (BSJ)

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

GOLDMAN, SACHS & CO. and FABRICE TOURRE,

Defendants.

CONSENT OF DEFENDANT GOLDMAN, SACHS & CO.

1. Defendant Goldman, Sachs & Co. ("Defendant" or "Goldman") acknowledges having been served with the complaint in this action, enters a general appearance, and admits the Court's jurisdiction over Defendant and over the subject matter of this action.

2. Without admitting or denying the allegations of the complaint (except as to personal and subject matter jurisdiction, which Defendant admits), Defendant hereby consents to the entry of the final Judgment in the form attached hereto (the "Final Judgment") and incorporated by reference herein, which, among other things:

(a) permanently restrains and enjoins Defendant from violation of Section 17(a) of the Securities Act of 1933 [15 U.S.C. § 77q(a)];

(b) orders Defendant to pay disgorgement in the amount of $15,000,000;

(c) orders Defendant to pay a civil penalty in the amount of $535,000,000 under Section 20(d)(2) of the Securities Act [15 U.S.C. § 77t(d)(2)]; and

(d) orders Defendant to comply with specified undertakings for three (3) years from the entry of the Final Judgment.

3. Goldman acknowledges that the marketing materials for the ABACUS 2007-AC1 transaction contained incomplete information. In particular, it was a mistake for the Goldman marketing materials to state that the reference portfolio was "selected by" ACA Management LLC without disclosing the role of Paulson & Co. Inc. in the portfolio selection process and that Paulson's economic interests were adverse to CDO investors. Goldman regrets that the marketing materials did not contain that disclosure.

4. Defendant acknowledges that the civil penalty paid pursuant to the Final Judgment may be distributed pursuant to the Fair Fund provisions of Section 308(a) of the Sarbanes-Oxley Act of 2002. Regardless of whether any such Fair Fund distribution is made, the civil penalty shall be treated as a penalty paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Defendant agrees that it shall not, after offset or reduction of any award of compensatory damages in any Related Investor Action based on Defendant's payment of disgorgement in this action, argue that it is entitled to, nor shall it further benefit by, offset or reduction of such compensatory damages award by the amount of any part of Defendant's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Defendant agrees

that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this action. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Defendant by or on behalf of one or more investors based on substantially the same facts as alleged in the complaint in this action.

5. Defendant agrees that it shall not seek or accept, directly or indirectly, reimbursement or indemnification from any source, including but not limited to payment made pursuant to any insurance policy, with regard to any civil penalty amounts that Defendant pays pursuant to the Final Judgment, regardless of whether such penalty amounts or any part thereof are added to a distribution fund or otherwise used for the benefit of investors. Defendant further agrees that it shall not claim, assert, or apply for a tax deduction or tax credit with regard to any federal, state, or local tax for any penalty amounts that Defendant pays pursuant to the Final Judgment, regardless of whether such penalty amounts or any part thereof are added to a distribution fund or otherwise used for the benefit of investors.

6. Defendant acknowledges that the Court is not imposing a civil penalty in excess of $535,000,000 based on Defendant's agreement to cooperate as set forth in Paragraph 17 below. Defendant consents that if at any time following the entry of the Final Judgment the Defendant does not comply in any

material respect with its agreement to cooperate, the Commission may, at its sole discretion with reasonable notice to the Defendant, petition the Court for an order requiring Defendant to pay an additional civil penalty. In connection with the Commission's motion for civil penalties, and at any hearing held on such a motion: (a) Defendant will be precluded from arguing that it did not violate the federal securities laws as alleged in the Complaint; (b) Defendant may not challenge the validity of the Final Judgment, this Consent, or any related Undertakings; (c) the allegations of the Complaint, solely for the purposes of such motion, shall be accepted as and deemed true by the Court; and (d) the Court may determine the issues raised in the motion on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence without regard to the standards for summary judgment contained in Rule 56(c) of the Federal Rules of Civil Procedure. Under these circumstances, the parties may take discovery, including discovery from appropriate non-parties.

7. Defendant agrees to comply with the following undertakings, which shall expire three (3) years from the entry of the Final Judgment herein;

(a) Product Review and Approval

Firmwide Capital Committee. Defendant shall expand the role of its Firmwide Capital Committee (or any successor committee, the "FCC") in the vetting and approval process for offerings of residential mortgage-related securities, including, but not limited to, collateralized debt obligations that reference such securities (collectively "mortgage securities"). Except as described below, offerings of mortgage securities by Defendant's Mortgage Department will first be presented to the Structured Finance Capital Committee (or any successor committee, the "SFCC"), formerly the Mortgage Capital Committee. If the transaction is approved by the SFCC, it shall then be presented to the FCC, which, among other things, shall have the right in its sole discretion to approve or reject any such offerings. The FCC, in its discretion, may direct that some or all mortgage securities offerings shall be brought directly to the FCC. The FCC shall ensure that processes are in place so that written marketing materials (as defined below) for mortgage securities offerings do not include any material misstatement or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

(b) Role of Internal Legal and Compliance

1. Marketing Materials. All written marketing materials (i.e., investor presentations or "flip books," term sheets, and offering circulars/ prospectuses) used in connection with mortgage securities offerings must be reviewed by representatives of Defendant's Legal Department or Compliance Department. The review process shall also include a review of the relevant memoranda presented to the FCC/SFCC as part of the approval process for mortgage securities offerings and all other material terms of the proposed transaction. Defendant shall establish and maintain a centralized process to record these reviews through recordation and retention of:

a. The name of each person in the Legal Department or the Compliance Department who reviewed the materials;

b. The date of completion of review; and

c. A list of the materials reviewed.

2. Internal Audit. On at least an annual basis, Defendant's internal audit function shall conduct a review to determine that these requirements are being complied with. Any deficiencies noted by internal audit shall be promptly addressed by Defendant.

(c) Role of Outside Counsel

In offerings of mortgage securities where Defendant is the lead underwriter and retains outside counsel to advise on the offering, such counsel will be asked to review the term sheets, if any, the offering circular or prospectus, and the form of any other marketing materials used in connection with the offering. In order to enhance the effectiveness of its review, outside counsel will be provided with the relevant FCC and/or SFCC memoranda as background information and such other documents necessary to reflect all material terms of the transaction.

(d) Education and Training

1. Within sixty (60) days following the hiring by, or transfer to, Defendant's Mortgage Department of new individuals who will be involved with the structuring or marketing of mortgage securities offerings, each such person shall participate in a training program that includes, among other matters, instruction on the disclosure requirements under the Federal securities laws and that specifically addresses the application of those requirements to offerings of mortgage securities.

2. Not less frequently than annually, each person in Defendant's Mortgage Department who is involved in the structuring or marketing of mortgage securities offerings shall participate in a training seminar that covers, among other matters, disclosure requirements under the Federal securities laws applicable to offerings of mortgage securities. The first training seminar shall take place not later than sixty (60) days following the date of the Final Judgment.

3. Defendant shall provide for appropriate record keeping to track compliance with these requirements.

(e) Certification of Compliance by Defendant

The General Counsel or the Global Head of Compliance of Defendant shall certify annually (one year, two years, and three years, respectively, after the date of entry of this Final Judgment), in writing, compliance in all material respects with the undertakings set forth above. The Commission staff may make reasonable requests for further evidence of compliance, and Defendant agrees to provide such evidence. The certification and any such additional materials shall be submitted to Kenneth R. Lench, Chief of the Structured and New Products Unit, with a copy to the Office of Chief Counsel of the Enforcement Division.

In addition, Defendant acknowledges that it is presently conducting a comprehensive, firmwide review of its business standards. This review includes, among other things, an evaluation of Defendant's conflict management, disclosure and transparency of firmwide activities, structured products and suitability, education, training and business ethics, and client relationships and responsibilities. The Commission has taken this review into account in connection with the settlement of this matter.

8. Defendant waives the entry of findings of fact and conclusions of law pursuant to Rule 52 of the Federal Rules of Civil Procedure.

9. Defendant waives the right, if any, to a jury trial and to appeal from the entry of the Final Judgment.

10. Defendant enters into this Consent voluntarily and represents that no threats, offers, promises, or inducements of any kind have been made by the Commission or any member, officer, employee, agent, or representative of the Commission to induce Defendant to enter into this Consent.

11. Defendant agrees that this Consent shall be incorporated into the Final Judgment with the same force and effect as if fully set forth therein.

12. Defendant will not oppose the enforcement of the Final Judgment on the ground, if any exists, that it fails to comply with Rule 65(d) of the Federal Rules of Civil Procedure, and hereby waives any objection based thereon.

13. Defendant waives service of the Final Judgment and agrees that entry of the Final Judgment by the Court and filing with the Clerk of the Court will constitute notice to Defendant of its terms and conditions. Defendant further agrees to provide counsel for the Commission, within thirty days after the Final Judgment is filed with the Clerk of the Court, with an affidavit or declaration stating that Defendant has received and read a copy of the Final Judgment.

14. Consistent with 17 C.F.R. 202.5(f), this Consent resolves only the claims asserted against Defendant in this civil proceeding. Defendant acknowledges that no promise or representation has been made by the Commission or any member, officer, employee, agent, or representative of the Commission with regard to any criminal liability that may have arisen or may arise from the facts underlying this action or immunity from any such criminal liability. Defendant waives any claim of Double Jeopardy based upon the settlement of this proceeding, including the imposition of any remedy or civil penalty herein. Defendant further acknowledges that the Court's entry of a permanent injunction may have collateral consequences under federal or state law and the rules and regulations of self-regulatory organizations, licensing boards, and other regulatory organizations. Such collateral consequences include, but are not limited to, a statutory disqualification with respect to membership or participation in, or association with a member of, a self-regulatory organization. This statutory disqualification has consequences that are separate from any sanction imposed in an administrative proceeding. In addition, in any disciplinary proceeding before the Commission based on the entry of the injunction in this action, Defendant understands that it shall not be permitted to contest the factual allegations of the complaint in this action.

15. Defendant understands and agrees to comply with the Commission's policy "not to permit a defendant or respondent to consent to a judgment or order that imposes a sanction while denying the allegations in the complaint or order for proceedings." 17 C.F.R. § 202.5. In compliance with this policy, Defendant agrees: (i) not to take any action or to make

or permit to be made any public statement denying, directly or indirectly, any allegation in the complaint or creating the impression that the complaint is without factual basis; and (ii) that upon the filing of this Consent, Defendant hereby withdraws any papers filed in this action to the extent that they deny any allegation in the complaint. If Defendant breaches this agreement, the Commission may petition the Court to vacate the Final Judgment and restore this action to its active docket. Nothing in this paragraph affects Defendant's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which the Commission is not a party.

16. Defendant hereby waives any rights under the Equal Access to Justice Act, the Small Business Regulatory Enforcement Fairness Act of 1996, or any other provision of law to seek from the United States, or any agency, or any official of the United States acting in his or her official capacity, directly or indirectly, reimbursement of attorney's fees or other fees, expenses, or costs expended by Defendant to defend against this action. For these purposes, Defendant agrees that Defendant is not the prevailing party in this action since the parties have reached a good faith settlement.

17. In connection with this action and any related judicial or administrative proceeding or investigation commenced by the Commission or to which the Commission is a party, Defendant (i) agrees to require its employees to make themselves available for interviews at such times and places reasonably requested by the Commission staff; (ii) agrees to require that its employees testify at trial and other judicial proceedings when requested by Commission

staff; (iii) will produce non-privileged documents and other materials as requested by the Commission staff; (iv) will accept service by mail or facsimile transmission of notices or subpoenas issued by the Commission for documents or testimony at depositions, hearings, or trials, or in connection with any related investigation by Commission staff; (v) appoints Defendant's undersigned attorney as agent to receive service of such notices and subpoenas; (vi) with respect to such notices and subpoenas, waives the territorial limits on service contained in Rule 45 of the Federal Rules of Civil Procedure and any applicable local rules, provided that the party requesting the testimony reimburses Defendant's travel, lodging, and subsistence expenses at the then-prevailing U.S. Government per diem rates; and (vii) consents to personal jurisdiction over Defendant in any United States District Court for purposes of enforcing any such subpoena.

18. Defendant agrees that the Commission may present the Final Judgment to the Court for signature and entry without further notice.

19. Defendant agrees that this Court shall retain jurisdiction over this matter for the purpose of enforcing the terms of the Final Judgment.

Dated: July 14, 2010

/s/ Goldman, Sachs & Co.
Goldman, Sachs & Co.

By: /s/ Gregory K. Palm
Gregory K. Palm
Managing Director and
General Counsel
Goldman, Sachs & Co.
200 West Street,
15th Floor
New York, NY 10282

On July 14, 2010, Gregory K. Palm, a person known to me, personally appeared before me and acknowledged executing the foregoing Consent with full authority to do so on behalf of Goldman Sachs, & Co. as its General Counsel.

/s/ Norman Feit
Notary Public
Commission expires:

[STAMP]

Approved as to form:

/s/ Richard H. Klapper

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

Master File No. 1:10-cv-03461-PAC

CLASS ACTION
JURY TRIAL DEMANDED
ECF CASE

In re GOLDMAN SACHS GROUP, INC.
SECURITIES LITIGATION

This Document Relates To: ALL ACTIONS.

CONSOLIDATED
CLASS ACTION COMPLAINT FOR
VIOLATIONS OF FEDERAL SECURITIES LAWS

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I. INTRODUCTION

Court appointed Lead Plaintiffs, the Arkansas Teacher Retirement System, the West Virginia Investment Management Board, and Plumbers and Pipefitters National Pension Fund (collectively, "Lead Plaintiffs"), by their undersigned attorneys, bring this action on behalf of themselves and all other similarly situated purchasers of the securities of The Goldman Sachs Group, Inc. ("Goldman" or "the Company") between February 5, 2007, and June 10, 2010, inclusive (the "Class Period").

Lead Plaintiffs allege the following upon personal knowledge as to themselves and their acts, and upon information and belief as to all other matters, based on the investigation of counsel. The investigation of counsel is predicated upon, among other things, review and analysis of: (i) documents filed publicly by Goldman with the Securities and Exchange Commission (the "SEC"); (ii) press releases, new articles, and other public statements issued by or concerning Goldman and other defendants named herein; (iii) research reports issued by financial analysts concerning Goldman's securities and business; and (iv) other publicly available information and data concerning Goldman and its securities, including information concerning investigations of Goldman and its affiliates by, among others: the United States Senate Permanent Subcommittee on Investigations ("Senate Subcommittee"); the SEC, including the investigation leading to the Complaints brought by the SEC against Goldman and one of its employees, Fabrice Tourre; the Financial Industry Regulatory Authority ("FINRA"); and the Financial Services Authority ("FSA") in the U.K., including the investigation leading to a substantial financial penalty on Goldman Sachs International ("GSI").

II. NATURE AND SUMMARY OF THE ACTION

1. This is a federal securities action on behalf of all persons and entities who purchased or otherwise acquired the publicly traded securities of Goldman from February 5, 2007 through June 10, 2010, inclusive and certain of its officers and directors for violations of the Securities Exchange Act of 1934 ("the Exchange Act").

2. On April 16, 2010, the SEC charged Goldman with securities fraud for collaborating with Paulson & Co., Inc. ("Paulson"), an important Goldman client, to create a portfolio of securities titled Abacus AC-1 ("Abacus") that was designed to fail, and for selling this toxic collateralized debt obligation ("CDO") to other Goldman clients without telling them of Paulson's role in creating Abacus or his massive short position on the CDO. In less than a year, Paulson earned more than $1 billion from shorting Abacus with Goldman's assistance. Goldman's clients, from whom Goldman concealed Paulson's key role in creating Abacus and his short position in the CDO, lost approximately $1 billion.

3. Following the SEC's announcement of securities fraud charges against Goldman, the Company's stock immediately plummeted from $184.27 to $160.70 per share, a loss of approximately $13 billion in shareholder value.

4. The next day, investors discovered that Goldman had concealed from the public that it had been under investigation by the SEC in connection with Abacus since August 2008, and that the SEC told Goldman in

July 2009 via a formal Wells Notice that the SEC was recommending the filing of securities fraud charges.

5. On April 25-26, 2010, the Senate Subcommittee released Goldman internal emails showing that, beginning in late 2006 through early 2008, Goldman made billions by betting against the very mortgage-related CDOs it sold to its clients, and structured and underwrote Abacus to fail – allowing one of its most important clients to reap billions at the expense of Goldman's other clients who bought Abacus.

6. On April 29, 2010, the *Wall Street Journal* revealed that Goldman was under investigation by the Department of Justice. On June 10, 2010, it was reported that in addition to Goldman's conduct in connection with Abacus, the SEC was investigating Goldman's conduct in the Hudson CDO, specifically whether Goldman rid itself of mortgage-backed securities and related CDOs on Goldman's books that it knew were going to decline by selling these securities to Goldman's clients who suffered billions in losses.

7. On July 15, 2010, Goldman agreed to pay the SEC $550 million for its conduct in the Abacus CDO. In connection with the settlement, Goldman acknowledged:

> [T]he marketing materials for the ABACUS 2007-AC1 transaction contained incomplete information. In particular, it was a mistake for the Goldman marketing materials to state that the reference portfolio was 'selected by' ACA Management LLC without disclosing the role of Paulson & Co. Inc. in the portfolio selection process and that Paulson's economic interests were adverse to CDO investors.

8. On April 13, 2011, the Senate Subcommittee issued a bi-partisan report authored by Senator Carl Levin and Senator Tom Coburn which concluded that Goldman had engaged in pervasive conflicts of interest with its clients. The Report issued formal findings of fact including that from 2006 through 2007, Goldman (i) identified toxic mortgage-backed securities and CDOs held on its books that Goldman believed would significantly decline in value and cause the Company to lose billions; (ii) packaged and sold these securities to Goldman's own clients; (iii) hid and made affirmative misrepresentations to hide the fact that Goldman had bet against these securities; and (iv) made billions at its own clients' expense when the value of these securities plummeted, just as Goldman anticipated they would.

9. The Senate identified four particular CDO deals in 2006-2007, Abacus, "Hudson," "Timberwolf," and "Anderson" in which Goldman engaged in the improper practice of recommending and selling securities to its clients while affirmatively hiding the fact it (or Paulson, a favored client) was placing bets that those same securities would significantly decline in value.[1]

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[1] On May 11, 2011, the Senate Subcommittee referred its report to the Department of Justice and SEC for review and determination as to whether Goldman defrauded its clients, and whether the Company's executives, including CEO Blankfein committed perjury before Congress. Additionally, on May 16, 2010, the New York Attorney General demanded documents from Goldman in connection with an investigation into Goldman's mortgage-related CDO securities practices.

10. During the Class Period, defendants made three categories of materially false and misleading statements and omissions.

11. First, beginning in July 2009, Goldman concealed from its quarterly and year-end SEC filings, press releases and investor conference calls that the Company had been notified in July 2009, via a formal Wells Notice, that the SEC had recommended filing securities fraud charges relating to Goldman's conduct in connection with Abacus. By failing to disclose the Wells Notice, Goldman hid its improper conduct of betting against (or allowing a favored client to bet against) the very toxic securities that Goldman designed to fail and packaged and sold to its clients.

12. Goldman also concealed from shareholders two additional Wells Notices received by Goldman employees on September 28, 2009 and January 29, 2010, that were also related to Abacus.

13. In October 2009, Goldman came under intense scrutiny about the more than $16 billion in bonuses it was scheduled to pay to Goldman's executives and employees. The Company embarked on a full fledged public relations campaign to promote its reputation as the preeminent Wall Street bank focused first and foremost on responsible business practices that placed their clients' needs paramount to all else. Goldman highlighted its $200 million donation to promote education, and CEO Blankfein even went so far as to claim that Goldman was doing "God's work" – all while concealing the fact that the SEC had told Goldman that it had recommended the filing of securities fraud charges against the Company.

14. On December 24, 2009, the *New York Times* disclosed that Goldman had created and sold

mortgage-related debts in CDOs, bet against these securities and made billions. Goldman immediately issued a public denial defending its CDO practices as necessary to meet "client demand." In doing so, Goldman again hid the fact that the SEC had already notified the Company that the SEC had recommended filing charges based on Goldman's fraudulent conduct that hurt – not benefited – Goldman's clients. Goldman also failed to disclose that the CDOs it sold were not in response to "client demand," but were designed to allow Goldman to rid itself of mortgage-related securities that it wanted off its books and sold to its clients to make billions.

15. Goldman also lied to the market on April 2, 2010, when it issued its 2009 Annual Report. In a letter to "Fellow Shareholders," the Company again defended its mortgage securitization practices, stating that "our short positions were not a 'bet against our clients.'" Goldman again omitted that it had known since July 2009 that the SEC had recommended filing securities fraud charges, and that the Company had engaged in the fraudulent conduct of profiting at the expense of its own clients.

16. In addition, Goldman concealed information about the Wells Notices from both its domestic and international securities regulators, FINRA and the FSA in the U.K., which ultimately fined Goldman $650,000 and approximately $27 million, respectively, for Goldman's failure to report the Wells Notices.

17. Had Goldman disclosed and not affirmatively concealed its receipt of the Wells Notices, the public would have learned of Goldman's fraudulent conduct, which when disclosed between April 16, 2010 and June 10, 2010, caused severe damage to Goldman's

stock price and caused Goldman's shareholders to lose billions.

18. The second category of false and misleading statements and omissions during the Class Period is comprised of those statements by Goldman beginning on February 7, 2007 in which the Company reassured investors that "***[w]e have extensive procedures and controls that are designed to identify and address conflicts of interest*** . . . ." These include statements in which Goldman specified that "we increasingly have to address potential conflicts of interest, ***including situations where our services to a particular client or our own proprietary investments or other investments conflict, or are perceived to conflict, with the interests of another client*** . . . ."[2]

19. Goldman's warnings to shareholders regarding potential conflicts of interest omitted the fact that it was indeed aware of the existence of such conflicts at the time. Unbeknownst to Goldman's clients and shareholders, at the behest of Goldman senior management, Goldman had designed the Abacus deal from the outset to allow the Paulson hedge fund to short more than $1 billion worth of Abacus securities at the direct expense of its other clients to whom Goldman had recommended and sold those same securities.

20. The above statements were materially false and misleading because they failed to disclose that Goldman had deliberately created actual conflicts of interest by engaging in transactions that were designed from the outset by the Company to allow a

[2] All emphasis is added unless otherwise indicated.

favored client to benefit at the expense of its other clients.

21. The third category of false and misleading statements and omissions during the Class Period is comprised of those statements by Goldman beginning in February 2007 in which the Company repeatedly told the public that its "best in class" franchise and continued success depended on the Company's reputation, honesty, integrity and commitment to put its clients' interests first above all else.

22. These statements failed to disclose Goldman's clear conflicts of interest with its own clients, whereby Goldman intentionally packaged and sold to its clients billions in securities that were designed to fail, while at the same time reaping billions for itself or its favored clients by taking massive short positions on these securities. The Senate Subcommittee concluded that Goldman's undisclosed conduct constituted a clear conflict of interest, finding:

> **Conflict Between Client Interests and Proprietary Trading**. In 2007, Goldman Sachs went beyond its role as market maker for clients seeking to buy or sell mortgage related securities, traded billions of dollars in mortgage related assets for the benefit of the firm without disclosing its proprietary positions to clients, and instructed its sales force to sell mortgage related assets, including high risk RMBS and CDO securities that Goldman Sachs wanted to get off its books, and utilizing key roles in CDO transactions to promote its own interests at the expense of investors, ***creating a conflict between the firm's proprietary interests and the interests of its clients***.

23. The then-chair of the Senate Subcommittee stated that:

> Investment banks such as Goldman Sachs were not simply market-makers, they were self-interested promoters of risky and complicated financial schemes that helped trigger the [financial] crisis[.] They bundled toxic mortgages into complex financial instruments, got the credit rating agencies to label them as AAA securities, and sold them to investors, magnifying and spreading risk throughout the financial system, and all too often betting against the instruments they sold and profiting at the expense of their clients.

24. The following are examples of the third category of Goldman's false and misleading statements and omissions. In every Annual Report from 2006-2010, Goldman emphasized The Goldman Sachs Business Principles, including:

> 1 ***Our clients' interests always come first***. Our experience shows that if we serve our clients well, our own success will follow.
>
> 2 Our assets are our people, capital and ***reputation. If any of these is ever diminished, the last is the most difficult to restore***. ***We are dedicated to complying fully with the letter and spirit of the laws, rules and ethical principles that govern us***. ***Our continued success depends upon unswerving adherence to this standard***.

* * *

> 14 ***Integrity and honesty are at the heart of our business***.

25. Goldman also repeatedly made specific statements and omissions in its SEC filings indicating that its undisclosed fraudulent conduct was not occurring – when in fact it was. Goldman warned its shareholders about the dangers posed by client conflicts of interest – all while omitting the fact that the Company was engaged in pervasive conflicts of interest by selling its clients securities that were designed to fail and profiting at their clients' expense. These include statements in which Goldman stressed:

> As we have expanded the scope of our businesses and our client base, we increasingly [must] address potential conflicts of interest***, including situations where our services to a particular client or our own [proprietary] investments or other interests conflict, or are perceived to conflict, with the interests of another client*** . . . .

Indeed, Goldman specifically identified the precise risks posed by client conflicts of interest and securities fraud violations that subsequently materialized when Goldman was sued by the SEC, stating that "conflicts could give rise to ***litigation or [regulatory] enforcement actions***." However, Goldman reassured investors, stating, ***"[w]e have extensive procedures and controls that are designed to identify and address conflicts of interest . . . ."***

26. Goldman's so-called "warnings" to shareholders regarding potential conflicts of interest created the false impression that it was unaware of the existence of any such conflicts at the time. At the same exact

time that it was issuing these warnings about potential conflicts, senior Goldman management was well-aware of the clear, direct, massive, but undisclosed conflicts created when Goldman shifted the risks of billions of dollars in toxic mortgage-backed securities from its books to its clients' books and made billions at its clients' expense.

27. Goldman publicly conveyed numerous other times during the Class Period the false and misleading message that it had placed its clients' interests paramount above all else, stating in form or substance what Goldman CEO Lloyd Blankfein stated in November 2009: "During our history, our Firm has been guided by three tenets – the needs and objectives of our clients, attracting talented and long term oriented people and ***our reputation and client franchise***."

28. As detailed in the SEC Complaint and settlement, the Senate Subcommittee Report, Goldman internal documents, and herein, Goldman's statements were false and misleading because Goldman purposefully failed to disclose its conduct whereby the Company packaged toxic securities that it wanted to clear from its books, sold them to its clients, and placed short bets against these securities, allowing Goldman to reap billions of dollars in profits at the direct expense of its clients.

29. Goldman's materially false and misleading statements and omissions caused Goldman's stock to trade at artificially inflated levels during the Class Period. When the SEC filed its securities fraud complaint against Goldman on April 16, 2010, the market learned that, contrary to Goldman's public representations, the Company had known that since late July 2009 that the SEC intended to bring formal

securities fraud charges based on Goldman's conduct in connection with Abacus, and that the Company had engaged in undisclosed conduct in which it profited at the direct expense of its clients who sustained severe losses. Goldman's stock plummeted from $184.27 to $160.70 per share, causing over a $13 billion loss in shareholder value.

30. The artificial inflation continued to dissipate from Goldman's stock price between April 16, 2010 and June 10, 2010, when the Senate Subcommittee released internal e-mails providing new details of Goldman's conduct in connection with Abacus, and the public learned that the SEC and Department of Justice were investigating Goldman's mortgage securitization practices beyond just the Abacus deal. On each of these dates, Goldman suffered a corresponding significant stock price decline, causing investors to suffer additional billions in damage.

III. JURISDICTION AND VENUE

31. The claims asserted herein arise under §§10(b) and 20(a) of the Exchange Act, 15 U.S.C. §§78j(b) and 78t(a), and SEC Rule 10b-5.

32. This Court has jurisdiction over the subject matter of this action pursuant to §27 of the Exchange Act.

33. Venue is proper in this District pursuant to §27 of the Exchange Act. Acts and transactions giving rise to the violations of law complained of herein occurred in this District.

IV. THE PARTIES

A. Plaintiffs

34. Lead Plaintiffs Arkansas Teacher Retirement System, the West Virginia Investment Management Board, and Plumbers and Pipefitters National Pension Fund each purchased Goldman common stock during the Class Period and was damaged thereby.

B. Defendants

35. Defendant Goldman is a financial holding company, headquartered in New York, New York, that provides global banking, securities and investment management services in the United States and internationally.

36. With respect to the CDO transactions underlying the allegations of this Complaint, Goldman senior management coordinated the activities of several Goldman subsidiaries, which acted in a collective and coordinated manner in a concerted effort to seek out customers and sell CDO securities, thereby transferring risks posed by the collapsing CDO market from Goldman to its clients. These Goldman subsidiaries include:

> Goldman Sachs & Co. ("GS&Co") a registered as a United States broker-dealer and is engaged in global investment banking, securities and investment management. GS&Co is Goldman's principal broker-dealer in the United States. Its principal executive offices are located in New York, New York; and
>
> Goldman Sachs International ("GSI"), which is engaged in global investment banking, securities and investment management. GSI

has offices in London and New York, and operates in the United States in conjunction with Goldman and GS&Co.

37. Because these Goldman subsidiaries were all acting in concert under common direction from Goldman senior management and for a common purpose, or, in the alternative, they were acting as agents of The Goldman Sachs Group, Inc. and they are referred to collectively herein as "Goldman," except where necessary to specify the particular entity.

38. Defendant Lloyd C. Blankfein ("Blankfein") is Chairman of the Board of Directors and Chief Executive Officer ("CEO") of Goldman. Blankfein participated in the issuance of improper statements, including the preparation of the improper press releases and SEC filings.

39. Defendant David A. Viniar ("Viniar") is Chief Financial Officer ("CFO") of Goldman. Viniar participated in the issuance of improper statements, including the preparation of the improper press releases and SEC filings.

40. Defendant Gary D. Cohn ("Cohn") is President of and Chief Operating Officer and a director of Goldman. Cohn participated in the issuance of improper statements, including the preparation of the improper press releases and SEC filings.

41. The defendants referenced above in ¶¶38-40 are referred to herein as the "Individual Defendants."

C. Relevant Non-Defendant Goldman Personnel

42. The following Goldman employees were involved in planning, creating, recommending and/or selling the CDO securities at issue in this Complaint:

(a) Daniel Sparks ("Sparks") was, at relevant times, Head of Goldman's Mortgage Department and a Partner in The Goldman Sachs Group, Inc.

(b) Jonathan Egol ("Egol") was, at relevant times, Head of Goldman's Correlation Trading Desk. On October 24, 2007, Egol was named a Managing Director of The Goldman Sachs Group, Inc.

(c) David Lehman ("Lehman") was, at relevant times, Head of the Goldman Commercial Mortgage Backed Securities Desk and Head of the CDO Origination Desk. Lehman was also a senior member of the Structured Products Group. On October 26, 2006, Lehman was named a Managing Director of The Goldman Sachs Group, Inc.

(d) Michael Swenson ("Swenson"), was, at relevant times, a Managing Director in the Structured Products Group Trading for The Goldman Sachs Group, Inc.

(e) Peter Ostrem ("Ostrem"), was, at relevant times, Head of Goldman's CDO Origination Desk. On October 26, 2007, Ostrem was named a Managing Director in The Goldman Sachs Group, Inc.

(f) Joshua Birnbaum ("Birnbaum") was, at relevant times, a Managing Director in the Structured Products Group Trading for The Goldman Sachs Group, Inc. He was among the Mortgage Department's top traders in ABX assets.

(g) Fabrice Tourre ("Tourre"), was, at relevant times, an Executive Director in the Structured Products Group Trading for The Goldman Sachs Group, Inc. Tourre also worked at the Correlation

Desk and was principally involved as a lead salesman in the Abacus CDO transaction.

(h) Jonathan Sobel ("Sobel") was, at relevant times, Head of Goldman's Mortgage Department. Sobel is also a Managing Director for The Goldman Sachs Group, Inc.

(i) Benjamin Case ("Case"), was, at relevant times, employed as a trader by Goldman Sachs & Co. on the CDO Origination Desk. Case was assigned lead responsibility for carrying out Goldman's liquidation agent functions.

(j) Matthew Bieber ("Bieber") was, at relevant times, employed on the CDO Origination Desk by Goldman Sachs & Co. Bieber was the assigned Deal Captain for the Anderson CDO.

(k) J. Michael Evans ("Evans"), was, at relevant times, Vice Chairman of The Goldman Sachs Group, Inc.

(l) Jon Winkelried ("Winkelried"), was, at relevant times, Co-President of The Goldman Sachs Group, Inc.

(m) Harvey Schwartz ("Schwartz"), was, at relevant times, Managing Director, Head of Global Sales and a Co-Head of the Securities division at The Goldman Sachs Group, Inc.

(n) Tom Montag ("Montag"), was, at relevant times, a Member of the Management Committee and Equities/FICC Executive Committee, and Co-Head of Global Securities at The Goldman Sachs Group, Inc.

(o) David Solomon ("Solomon"), was, at relevant times, Head of Investment Banking at The Goldman Sachs Group, Inc.

(p) Craig Broderick ("Broderick"), was, at relevant times, Chief Credit Officer of The Goldman Sachs Group, Inc.

(q) Melanie Herald-Granoff ("Herald-Granoff"), was, at relevant times, Vice-President of the Mortgage Bond-Trading Department at The Goldman Sachs Group, Inc.

(r) Mehra Cactus Raazi ("Raazi"), was, at relevant times, a Broker at The Goldman Sachs Group, Inc.

V. CLASS ACTION ALLEGATIONS

43. Lead Plaintiffs bring this action as a class action pursuant to Rule 23 of the Federal Rules of Civil Procedure on behalf of a class consisting of all persons or entities who purchased or otherwise acquired Goldman common stock during the Class Period and who were damaged thereby (the "Class"). Excluded from the Class are defendants and their families, the officers and directors of the Company, at all relevant times, members of their immediate families and their legal representatives, heirs, successors or assigns and any entity in which defendants have or had a controlling interest.

44. The members of the Class are so numerous that joinder of all members is impracticable. The disposition of their claims in a class action will provide substantial benefits to the parties and the Court. Goldman has over 525 million shares of common stock outstanding, owned by hundreds if not thousands of persons.

45. There is a well-defined community of interest in the questions of law and fact involved in this case. Questions of law and fact common to the members of the Class which predominate over questions which may affect individual Class members include:

(a) whether the Exchange Act was violated by defendants' acts as alleged herein;

(b) whether statements made by defendants to the investing public during the Class Period omitted and/or misrepresented material facts about the business and management of Goldman;

(c) whether the price of Goldman common stock was artificially inflated; and

(d) to what extent the members of the Class have sustained damages and the appropriate measure of damages.

46. Lead Plaintiffs' claims are typical of those of the Class because Lead Plaintiffs and the Class sustained damages from defendants' wrongful conduct.

47. Lead Plaintiffs will adequately protect the interests of the Class and have retained counsel who are experienced in class action securities litigation. Lead Plaintiffs have no interests which conflict with those of the Class.

48. A class action is superior to other available methods for the fair and efficient adjudication of this controversy.

VI. FACTS SUPPORTING DEFENDANTS' FALSE AND MATERIAL MISSTATEMENTS AND OMISSIONS AND SCIENTER AFTER THE SEC NOTIFIED GOLDMAN IN JULY

2009 THAT IT HAD RECOMMENDED FILING SECURITIES FRAUD CHARGES

49. The first category of false and misleading statements and omissions are those from July 2009 until June 2010, in which Goldman concealed from its quarterly and year-end SEC filings, press releases and investor conference calls that the Company had been notified in July 2009, via a formal Wells Notice, that the SEC had recommended filing securities fraud charges relating to Goldman's conduct in connection with Abacus. By failing to disclose the Wells Notice, Goldman hid its improper conduct of betting against (or allowing a favored client to bet against) the very toxic securities that Goldman designed to fail and packaged and sold to its clients.

A. Goldman's Undisclosed Conduct in Connection with Abacus

50. Abacus 2007-AC1 was a $2 billion synthetic CDO[3] whose reference obligations were BBB rated mid

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[3] A synthetic CDO such as Abacus combines a CDO and CDS. A CDO is an asset-backed security based on a portfolio of fixed-income collateral or notes, such as RMBS. To establish a CDO, an investment bank, such as Goldman, incorporates a special purpose vehicle ("SPV") to which equity investors contribute capital. A credit default swap ("CDS") is an over-the-counter (*i.e.*, not traded on formal exchange) derivative contract referencing a bond or other financial obligation (the "reference obligation"). The parties to a CDS are referred to as the protection buyer and the protection seller. The protection buyer makes fixed periodic payments, commonly referred to as premiums, to the protection seller. In exchange, the protection seller agrees to make a "contingent payment" to the protection buyer if the reference obligation experiences a defined credit event, such as a default. In the Abacus transaction, the sellers of protection and the noteholders take the long position – meaning they both take the position that the reference portfolio will perform – while the

and subprime RMBS securities issued in 2006 and early 2007. It was the last in a series of 16 Abacus CDOs referencing residential mortgage backed securities ("RMBS") designed by Goldman. Goldman served as the underwriter or placement agent, the lead manager, and the protection buyer, and also acted in other roles related to the CDO.

51. In mid-to-late 2006, Goldman was approached by the hedge fund Paulson, and asked to structure a transaction that would enable the hedge fund to short multiple RMBS securities. Goldman had previously worked with Paulson and was aware that Paulson held strong negative views of the residential mortgage market and was making investments based on that view. The Goldman Mortgage Capital Committee Memorandum seeking approval of Abacus 2007-AC1, for example, stated:

> Paulson is a large macro hedge fund that has taken directional views on the subprime RMBS market for the past few months. In 2006 the Desk worked an order for Paulson to buy protection on a supersenior tranche off a portfolio similar to the Reference Portfolio selected by ACA, and the AC1 Transaction is another mean[s] for Paulson to accomplish their trading objective: buying protection in tranched format on the subprime RMBS market.

52. An email sent to Daniel Sparks, head of the Mortgage Department, by Fabrice Tourre, a

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buyers of protection take the short position – meaning they take the position that the reference portfolio will default.

Correlation Trading Desk employee who led the effort on the Abacus CDO for Paulson, was even more blunt:

> Gerstie and I are finishing up engagement letters . . . for the large RMBS CDO ABACUS trade that will help Paulson short senior tranches off a reference portfolio of Baa2 subprime RMBS risk selected by ACA.

53. These documents make it clear that Goldman knew Paulson's investment strategy was to identify a reference portfolio of assets for the Abacus CDO that Paulson believed would perform poorly or fail, so that its short position would profit at the expense of the long investors. In addition, during his Subcommittee interview, Tourre made it clear that he was aware of the Paulson investment strategy.

54. Out of concern for its reputation, at least one investment bank that Paulson approached prior to Goldman declined to assist Paulson in structuring what would eventually be called Abacus. Scott Eichel of Bear Stearns, who reportedly met with Paulson several times, has been quoted as saying that Paulson wanted: "especially ugly mortgages for the CDOs, like a bettor asking a football owner to bench a star quarterback to improve the odds of his wager against the team." According to Eichel, such a transaction "didn't pass [Bear's] ethics standards; it was a reputation issue, and it didn't pass our moral compass. We didn't think we should sell deals that someone was shorting on the other side."

55. In response to the inquiry from Paulson, Goldman proposed structuring an Abacus CDO. Fabrice Tourre was given lead responsibility for organizing and structuring the Abacus transaction. Goldman's primary role was to act as an agent and

administrator of the CDO, obtaining its profit from the fees it charged for the services rendered, rather than from any investment in the CDO itself. In effect, Goldman "rented" the Abacus platform to the Paulson hedge fund and served as Paulson's agent in carrying out the hedge fund's investment objectives.

56. Paolo Pellegrini, Paulson's Managing Director who led Paulson's selection of the reference assets for the Abacus 2007-AC1 transaction, told the SEC that it was Goldman's idea to have a portfolio selection agent. At the same time, Goldman internal communications made it clear that the objective was to select a portfolio selection agent that would comply with Paulson's suggestions for the assets to be referenced in the CDO. In an email to colleagues discussing the matter, Tourre suggested finding a manager that:

> will be flexible w.r.t. [with respect to] portfolio selection (*i.e.*, ideally we will send them a list of 200 Baa2-rated 2006-vintage RMBS bonds that fit certain criteria, and the portfolio selection agent will select 100 out of the 200 bonds).

57. In the early part of January 2007, Tourre sent an email to prospective selection agents describing their anticipated role in the CDO. One of his points was the following:

> Reference Portfolio: static, fully identified upfront, and consisting of approx 100 equally-sized mezzanine subprime RMBS names issued between Q4 [the fourth quarter of] 2005 and today. Starting portfolio would be ideally what the Transaction Sponsor shared, but there is flexibility around the names.

58. Jonathan Egol, chief architect of the Abacus structure and head of the Correlation Trading Desk, suggested that Goldman approach GSC Partners ("GSC"), a New York hedge fund that Goldman had worked with on other CDOs, including Anderson. Tourre sent an email to colleagues asking:

> Do you think gsc is easier to work with than faxtor? They will never agree to the type of names paulson want[s] to use, I don't think steffelin [a senior trader at GSC] will be willing to put gsc's name at risk for small economics on a weak quality portfolio whose bonds are distributed globally.

A colleague replied:

> There are more managers out there than just GSC / Faxtor. The way I look at it, the easiest managers to work with should be used for our own axes. Managers that are a bit more difficult should be used for trades like Paulson given how axed Paulson seems to be (i.e. I'm betting they can give on certain terms and overall portfolio increase).

59. On January 4, 2007, on behalf of Paulson, Goldman approached GSC as well as two other companies to act as the portfolio selection agent for the Abacus CDO. Shortly thereafter, Tourre reported to his colleagues that GSC had declined the offer to act as the Abacus portfolio selection agent due to its negative views of the assets Paulson wanted to include in the CDO:

> As you know, a couple of weeks ago we had approached GSC to ask them to act as portfolio selection agent for that Paulson-sponsored trade, and GSC had declined given

their negative views on most of the credits that Paulson had selected.

60. Later, when Goldman began to market Abacus 2007-AC1 securities, Edward Steffelin, a senior trader at GSC, sent an email to Peter Ostrem, head of Goldman's CDO Origination Desk saying: "I do not have to say how bad it is that you guys are pushing this thing." When asked by the Subcommittee what he meant, Steffelin responded that he believed that particular Abacus CDO created "reputational risk" for GSC as the collateral manager and for the whole market.

61. Without disclosing Paulson's intended role as the sole short party, Goldman and Paulson approached ACA Capital Management, LLC ("ACA"), a company with experience in selecting assets for CDOs. ACA agreed to act as the portfolio selection agent and Goldman employees expressed hope that ACA's involvement would improve the sales of the Abacus securities. In an internal memorandum seeking approval of the CDO, for example, Goldman personnel wrote: "We expect to leverage ACA's credibility and franchise to help distribute this Transaction."

62. During January, February, and March 2007, the Abacus reference assets were selected. The Paulson hedge fund initiated the asset selection process by providing Goldman with criteria for choosing RMBS securities for the CDO. According to Tourre, Goldman's subsequent identification of candidate assets was essentially ministerial, as Paulson's specified criteria had restricted the scope of the RMBS securities that could be proposed. For example, Paulson wanted RMBS securities that had adjustable rate mortgages, low borrower FICO scores,

and mortgages in states with slowing home price appreciation, like Arizona, California, Florida, and Nevada. Paulson specifically required 2006-vintage or 2007-vintage subprime RMBS that were rated BBB by S&P or Baa2 by Moody's. Goldman sent Paulson a database and spreadsheet listing the securities that met Paulson's criteria. Paulson used that database to select 123 securities, and Goldman forwarded the resulting list to ACA. Over the next two months, a series of negotiations and meetings took place to finalize selection of the reference assets and the structure of the CDO.

63. On March 22, 2007, ACA and Paulson agreed on the final $2 billion reference portfolio for Abacus 2007-AC1. The assets consisted of 90 Baa2 rated mid and subprime RMBS securities issued after January 1, 2006.

64. Goldman characterized Paulson's participation in the asset selection process as one in which the hedge fund merely "express[ed] [its] views" about the reference portfolio, which often happens in synthetic CDO transactions. The evidence indicates, however, that Paulson did more than express its views; it played an active and determinative role in the asset selection process. Paulson established the criteria used to identify the initial list of RMBS securities, proposed a majority of the reference assets in the final portfolio, and approved 100% of the reference assets.

65. Moreover, the "views" expressed by Paulson directly conflicted with the interests of the investors to whom Goldman was marketing the Abacus 2007-AC1 deal. Pellegrini was quite clear about Paulson's intentions in a deposition with the SEC:

> Question: Your portfolio analysis was designed in large part to identify bonds that weren't going to perform, right?
>
> Answer: Right.
>
> Question: Because you wanted to short those bonds?
>
> Answer: Right.

66. Notwithstanding Paulson's direct involvement in the asset selection process, the Abacus Marketing book falsely identified ACA as the only portfolio selection agent for the CDO, and stated that the portfolio selection agent had selected the reference assets. The Abacus Offering Memorandum stated: "The Initial Reference Portfolio will be selected by ACA Management, L.L.C."

67. Evidence obtained by the Senate Subcommittee indicates that Paulson's role in the Abacus asset selection process and its investment objectives for the CDO were not fully or accurately disclosed to key parties or investors at the time the CDO was being structured and sold.

68. Moody's, one of the credit rating agencies asked to rate the Abacus securities, was not informed of Paulson's role or investment objectives. At a Senate Subcommittee hearing on the role of the credit rating agencies in the financial crisis, Eric Kolchinsky, a former Moody's managing director who oversaw its CDO ratings and was familiar with Abacus 2007-AC1, provided sworn testimony that he had not known of Paulson's involvement with the CDO at the time it was rated, did not know of Paulson's role in selecting the referenced assets, and believed his staff did not know either. He testified that allowing an entity that wants

a CDO to "blow up" to pick its assets "changes the whole dynamic," and was information that he would have wanted to know when rating the securities:

> Senator Levin: And were you or your staff aware at the time that Moody's was working on the ABACUS rating that Paulson was shorting the assets in Abacus and playing a role in selecting referenced assets expected to perform poorly?
>
> Mr. Kolchinsky: I did not know, and I suspect, I am fairly sure, that my staff did not know either.
>
> Senator Levin: And are these facts that you or your staff would have wanted to know before rating ABACUS?
>
> Mr. Kolchinsky: From my personal perspective, it is something that I would have wanted to know because it is more of a qualitative not a quantitative assessment if someone who intends the deal to blow up is picking the portfolio. But, yes, that is something that I would have personally wanted to know. It changes the incentives in the structure.
>
> Senator Levin: Are people usually putting deals together that want the deal to succeed? Isn't that the usual assumption?
>
> Mr. Kolchinsky: That is the basic assumption, yes.
>
> Senator Levin: And if the person wanting the deal to blow up is picking the assets, that would run counter to what the usual assumption is?

> Mr. Kolchinsky: It just changes the whole dynamic of the structure where the person who is putting it together, choosing it, wants it to blow up.

Moody's assigned AAA ratings to two tranches of the Abacus CDO.

69. ACA told the Senate Subcommittee that, throughout the asset selection process, it was not informed and remained unaware of Paulson's true investment objective, which was to identify and short a set of assets that it believed would not perform and would lose value. According to ACA, it believed that Paulson was going to be a long investor in the CDO through its purchase of the equity share that would incur the first losses in the CDO.

70. Contemporaneous ACA documents support that position. An internal ACA Commitments Committee Memorandum on Abacus 2007-AC1 dated February 12, 2007, for example, stated: "The hedge fund is taking the 0-9% tranche." Ten days later, on February 23, 2007, the ACA Managing Director who worked on the Abacus transaction spoke with a Goldman representative, and took notes of the conversation which stated in part: "Paulson taking 0-10%."

71. In April 2007, the same ACA Managing Director sent an email to the CEO and President of ACA's parent company, ACA Capital Holdings Inc., which was considering buying Abacus securities for itself. Her email stated: "We did price $192 million in total of Class Al and A2 today to settle April 26th. Paulson took down a proportionate amount of equity (0-10% tranche)."

72. In addition, on January 10, 2007, a few days after ACA was first approached by Goldman about

working on the Abacus CDO, Tourre sent ACA a "Transaction Summary" describing the proposed transaction. The Transaction Summary identified the Paulson hedge fund as the "Transaction Sponsor," described the "Contemplated Capital Structure" of the CDO, and indicated that the lowest tranche, "[0]%-[9]%," was "pre-committed first loss." The ACA Managing Director told the Subcommittee that the "[0]%-[9]%" tranche identified in the Transaction Summary matched the general description of an equity tranche, and the wording suggested that someone had already committed to buy it. She explained that it was typical for a CDO sponsor to purchase the equity tranche, and she believed that Paulson, as the Abacus "sponsor," had committed to buy that tranche.

73. The Abacus Marketing book also specified that the "First Loss" tranche of the CDO, of a "[+10%]" size, was "Not Offered" for sale. The ACA Managing Director declared in a statement to the SEC that she had interpreted the phrase, "Not Offered," to indicate the equity tranche had been "pre-placed" and "ha[d] already been committed to purchase by an investor and [would] not be marketed." She thought that investor was the Paulson hedge fund.

74. When asked about the Transaction Summary description of the lowest tranche in the Abacus CDO, Tourre told the Senate Subcommittee that the phrase "pre-committed first loss" normally indicated that the tranche had been sold. He stated that he actually meant to communicate that the tranche had not been sold, and that portion of the Transaction Summary was poorly worded.

75. ACA has since filed a civil lawsuit against Goldman asserting that Goldman did not inform ACA

that "Paulson intended to take an enormous short position" in Abacus and is seeking compensatory damages and punitive damages for fraudulent inducement, fraudulent concealment, and unjust enrichment.

76. Regardless of the communications between Goldman and ACA, it is clear that the Abacus marketing material and offering documents provided by Goldman to investors contained no mention of Paulson's short position in the CDO nor the significant role it played in the selection of the CDOs reference assets. This was confirmed by Tourre at the Senate Subcommittee hearing:

> Senator Levin: And was it reflected in the Goldman Sachs security offering to investors that Paulson had been part of the selection process? Was that represented in that document?
>
> Mr. Tourre: Paulson was not disclosed in the Abacus 07 AC-1 transaction, Mr. Chairman.
>
> Senator Levin: It was not?
>
> Mr. Tourre: No, it was not.

77. Still another troubling omission was Goldman's failure to advise potential Abacus investors that the firm's own economic interests were aligned with those of the Paulson hedge fund. As part of the Abacus CDO arrangement, Paulson agreed to pay Goldman a higher fee if Goldman could provide Paulson with CDS contracts containing premium payments below a certain level. The problem with the fee incentive offer was that, while lower premiums would result in lower costs to Paulson, it would also result in lower premium payments to the CDO, directly reducing the amount of

cash available to the long investors. The Paulson-Goldman compensation arrangement, thus, created a direct conflict of interest between Goldman and the investors to whom it was selling the Abacus securities.

78. Abacus 2007-AC1 closed, and its securities were issued on April 26, 2007. They were issued later than the securities from the Hudson, Anderson, and Timberwolf CDOs and hit the market as subprime mortgages were hitting record delinquency and default rates. Goldman sold the Abacus 2007-AC1 securities to just three investors: IKB, the German bank; ACA, the portfolio selection agent; and ACA Financial Guaranty Corp., the owner of ACA and a wholly owned subsidiary of ACA Capital Holdings Inc. IKB bought $150 million of the AAA rated Abacus securities. ACA bought about $42 million in the AAA securities for placement in another CDO it was managing. ACA Financial Guaranty Corp. was by far the largest investor, taking the long side of a $909 million CDS contract referencing the super senior portion of the CDO. Goldman took the short side of the CDS contract, which it then transferred to Paulson.

79. Within months, the high risk subprime mortgages underlying the RMBS securities referenced in the Abacus portfolio incurred steep rates of default, and the Abacus securities began to lose value. According to the SEC, by October 2007, six months after the securities were issued, 83% of the underlying assets had received a credit rating downgrade and 17% of the underlying assets had been placed on a negative credit watch. On October 26, 2007, a Goldman employee sent an email about Abacus 2007-AC1 with an assessment even more negative than that of the SEC:

> This deal was number 1 in the universe of CDO's that were downgraded by MOODY'S and S&P. 99.89% of the underlying assets were downgraded.

80. While Sparks testified that, in 2007, the Mortgage Department expected its CDOs "to perform," a contemporaneous draft presentation that he helped prepare in May 2007 stated that the "desk expects [the CDOs] to underperform." Many other emails provide his negative views of the CDO market at the time, including emails in which Sparks described the subprime market as "bad and getting worse," and directed Goldman's mortgage traders to "[g]et out of everything," and "stay on the short side." He wrote, among other things: "Game over," "bad news everywhere," and "the business is totally dead."

81. The three long investors in Abacus 2007-AC 1 together lost more than $1 billion. As the sole short investor, Paulson recorded a corresponding profit of about $1 billion.

82. In addition to reaping the millions of dollars in fees for structuring the Abacus 2007-AC 1 CDO, Goldman also profited by purchasing CDS protection or equity puts on ACA's stock, essentially betting that the stock price would fall or the company would lose value. Specifically, after ACA Financial Guaranty Corp., the parent company of ACA Management which acted as the collateral manager of Abacus 2007-AC1, purchased Abacus securities, Goldman purchased the short side of a CDS contract that referenced ACA Financial Guaranty. Once ACA Financial Guaranty encountered extreme financial distress in late 2007, Goldman made millions of dollars from ACA's misfortune – ironically, misfortune ultimately caused by Goldman.

B. The SEC Files Securities Fraud Charges that Goldman Settled for $550 Million

83. On April 16, 2010, the SEC filed a complaint against Goldman and Tourre alleging violations of Section 17(a) of the Securities Act of 1933, as well as Section 10(b) and Rule 10b-5 of the Exchange Act. The SEC contended that Goldman had failed to disclose to potential investors materially adverse information to its clients, stating:

> In sum, GS&Co arranged a transaction at Paulson's request in which Paulson heavily influenced the selection of the portfolio to suit its economic interests, but failed to disclose to investors, as part of the description of the portfolio selection process contained in the marketing materials used to promote the transaction, Paulson's role in the portfolio selection process or its adverse economic interests.

84. The day after the SEC filing, Lorin Reisner ("Reisner"), Deputy Director, Division of Enforcement, wrote in an e-mail to John Nester ("Nester"), Director, Office of Public Affairs, and Robert Khuzami ("Khuzami"), Deputy Director, Division of Enforcement:

> Goldman's counsel had numerous discussions with staff and a senior-level meeting in DC with Rob and me. No mention of pursuing settlement by Goldman. It was obvious that ***we were serious and planned to pursue charges***.

85. On April 18, 2010, Khuzami wrote in an e-mail to Nester, Reisner and others:

> [Goldman] attended a March mtg on [the Goldman Manager] and the ***seriousness of the matter was quite apparent***. Every other counsel we have been involved with in a Wells process ***knows it is serious and conveys an intent to recommend charges*** and thus lets us know that settlement is an option, or asks for that heads-up if charges are imminent.

86. On July 14, 2010, Goldman reached a $550 million settlement with the SEC. In connection with the settlement, Goldman acknowledged:

> [T]he marketing materials for the ABACUS 2007-AC1 transaction contained incomplete information. In particular, it was a mistake for the Goldman marketing materials to state that the reference portfolio was "selected by" ACA Management LLC without disclosing the role of Paulson & Co. Inc. in the portfolio selection process and that Paulson's economic interests were adverse to CDO investors.

87. In sum, Goldman failed to disclose to its own clients that it had engaged in fraudulent conduct which created clear conflicts of interest with its clients, including that it constructed Abacus to help Paulson, a favored client short multiple RMBS securities, and profit at the expense of other Goldman clients. Goldman further failed to disclose that it allowed Paulson to play a significant role in the selection of the CDOs referenced assets, while employing an outside portfolio agent to give the impression that the CDO assets were selected by a disinterested third party. Goldman also failed to disclose Paulson's investment objective and asset selection role to a credit rating agency that assigned

AAA ratings to two tranches of the Abacus securities. In addition, Goldman failed to disclose to the investors its compensation arrangement that provided incentives for Goldman to minimize the premium payments into the CDO. Within six months, the Abacus securities began incurring losses and ratings downgrades. Goldman watched its clients to whom it had sold the securities lose virtually all the funds they had invested, while its favored client Paulson walked away with a profit of approximately $1 billion.

C. Goldman's Receipt of the Wells Notice in July 2009

88. In August 2008, the SEC notified Goldman that it was commencing an investigation into Abacus and served Goldman with a subpoena. Goldman responded by producing approximately eight million pages of documents. The SEC took five days of testimony from Goldman's most senior management with responsibility over the Abacus transaction. Among others, the SEC took testimony from Gail Kreitman, a managing director, Melanie Herald-Granoff, a vice-president in the mortgage bond-trading department, and Fabrice Tourre, the Goldman vice president with lead responsibility for structuring and marketing Abacus.

89. In early February 2009, four senior personnel at Goldman were informed that Tourre and another Goldman employee (later identified as Jonathan Egol) had been asked to give testimony in connection with the SEC investigation.

90. On July 29, 2009, the SEC issued a Wells Notice to Goldman. A Wells Notice provides notice to a person or entity that the SEC intends to recommend an enforcement action and affords the respondent an

opportunity to respond concerning the recommendation.

91. Goldman provided written Wells submissions to the SEC Enforcement Staff on with the SEC Enforcement Staff on September 15, 2009, and Goldman senior management and counsel met with the SEC Enforcement Staff on a number of occasions up until the April 16, 2010 SEC fraud charge, even as it provided both formal and informal responses to the SEC. Goldman hid existence of the Wells Notice, omitting any mention in its financial statements and public announcements.

92. Top-level senior managers at Goldman were consulted with and made aware of the SEC investigation, including the Wells Notices. Yet, during the Class Period, Goldman did not reveal any information pertaining to this investigation. Nor was information about the SEC investigation available to the public.

93, The SEC Enforcement Staff also issued a Wells Notice to Tourre on September 28, 2009. Tourre made a written Wells submission on October 26, 2009, and met with the SEC Enforcement Staff on October 29, 2009.

94. Additionally, on January 29, 2010, the SEC Enforcement Staff issued a Wells Notice to a "Goldman Manager" on the Abacus transaction, subsequently identified as Jonathan Egol who was head of Goldman's Correlation Trading Desk. Egol provided a written Wells submission on February 24, 2010 and met with the Staff on March 4, 2010.

95. In direct violation of long-standing rules set forth by its domestic and international regulators, FINRA and FSA, respectively, Goldman failed to

timely report Wells Notices issued to Tourre and Egol, who played primary roles in Abacus. Until the SEC filed its securities fraud complaint against Goldman on April 16, 2010, Goldman hid the Wells Notice received by the Company and the Wells Notices received by Tourre and Egol from its investors and regulators, as well as the existence of an SEC investigation.

96. Had Goldman timely disclosed the Wells Notices served on the Company, or either of its two employees, the public would have discovered the SEC investigation of the Abacus transaction and Goldman's undisclosed fraudulent conduct.

97. From the time Goldman received the first Wells Notice in July 2009 until the SEC filed its complaint on April 16, 2010, Goldman failed to disclose that it could potentially suffer corresponding material adverse effects, including:

(a) the filing of a formal SEC complaint;

(b) questions arising as to Goldman's integrity and the manner in which it conducts various lines of business;

(c) the impairment of certain highly profitable lines of business as a result of any governmental investigations;

(d) the impairment of certain highly profitable lines of business as a result of a loss of confidence in Goldman in the marketplace by clients that would normally do business with Goldman; and

(e) the possibility of criminal prosecution arising as a result of the civil investigation that would further disrupt Goldman's lines of business and cause further long-term damage to its professional reputation.

98. Additionally, Goldman's failure to disclose the SEC investigation and Wells Notices from both the investing public and from its foreign and domestic regulators strongly suggests a knowing effort to conceal rather than a mere failure of oversight.

99. Goldman's failure to timely disclose any Abacus Wells Notice, rendered its statements from August 2009 through April 2010 false, incomplete, and misleading and caused its stock to trade at artificially inflated levels during the Class Period. Upon news of the SEC complaint, on April 16, 2010 Goldman's stock plummeted from $184.27 to $160.70 per share, causing more than a $13 billion loss in shareholder value.

D. Goldman Admitted that It Violated the Rules of Its Securities Regulators by Failing to Disclose Its Receipt of Wells Notices Relating to Abacus

100. On May 10, 2010, Goldman disclosed that it had received notices of investigation from FINRA, the industry's self-regulator, and Britain's FSA relating to the Company's conduct in connection with Abacus. On November 9, 2010, FINRA announced that it had fined Goldman $650,000 for failing to disclose that Fabrice Tourre, the trader primarily responsible for structuring and marketing Abacus, and another employee, had received a Wells notice in September 2009.

101. Goldman admitted in its settlement with FINRA that it hid the Wells Notice received by Tourre from the investing public in violation of FINRA rules. Specifically, under NASD Conduct Rule 3010 and

FINRA Rule 2010, financial firms, like Goldman, are required to report a Wells Notice to FINRA within 30 days. The existence of the Wells Notice is then posted in a database that can be viewed by the public. As explained in Goldman's Settlement with FINRA:

> In August 2008, the SEC began seeking information from Goldman regarding Abacus, including the names of the principal employees responsible for Abacus and emails related to the CDO offering. Over the next year and a half, the SEC obtained documents and testimony from Goldman and a number of its employees related to the genesis, structuring and marketing of the Abacus transaction.
>
> Tourre had worked as a Vice President on the structured product correlation trading desk at Goldman's headquarters in New York City when Abacus was structured and marketed. On March 3-4, 2009, Tourre, who at the time had become an Executive Director working in London for the firm's Goldman Sachs International ("GSI") affiliate, testified at the SEC in Washington, D.C. in connection with the Abacus investigation.[4]

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[4] GSI is a London-based wholly owned subsidiary of The Goldman Sachs Group, Inc. GSI is not a FINRA member firm. In a settlement with the United Kingdom's FSA announced on September 9, 2010, GSI paid a substantial fine in connection with the FSA's finding that GSI had failed to have proper and effective systems and controls in place to ensure that its Compliance department was apprised of information about the SEC's investigation of Goldman and Tourre.

Tourre's counsel received a written Wells Notice, dated September 28, 2009, stating that the staff of the SEC intended to recommend that the SEC file a civil action and institute a public administrative proceeding against Tourre alleging that he violated Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder in connection with the CDO offering. Tourre was registered with FINRA through Goldman at the time he received the Wells Notice. ***Tourre's counsel immediately informed Goldman's Legal Department that the Wells Notice had been received***.

* * *

Thus, receipt of a written Wells notice clearly triggers a reporting obligation on a person's Form U4. Despite the fact that the reporting obligation clearly existed, Goldman failed to ensure that Tourre's Form U4 was amended within 30 days of its knowledge of the Wells Notice, as required under the By-Laws. ***Tourre's Form U4 was not amended until May 3, 2010, more than seven months after Goldman learned of the Wells Notice, and only after the SEC filed its Complaint against Goldman and Tourre on April 16, 2010 (resulting in extensive news coverage.)***

102. As detailed in the FINRA Settlement, Goldman also hid receipt of an additional Wells Notice to another unidentified Goldman employee (later identified as Egol) from the investing public.

> ***Goldman's failure vis-à-vis Tourre's Form U4 was not an isolated incident***. Another Goldman employee in New York also received a written Wells Notice during the Relevant Period [Between November 2009 and May 2010], indicating that the staff of a regulatory agency had made a preliminary determination to recommend that disciplinary action be brought against him. The employee was registered with FINRA through Goldman at the time he received the Wells Notice. ***In this instance, too, Goldman's Legal Department was promptly informed that a Wells Notice had been received***. Goldman, however, did not ensure that the Form U4 was amended within 30 days of its knowledge of the Wells Notice, as required under the By-Laws.

103. In settling with FINRA, Goldman admitted:

> Between November 2009 and May 2010 (the "Relevant Period"), in two instances Goldman failed to update Uniform Applications for Securities Industry Registration or Transfer ("Forms U4") to disclose investigations when it was required to do so by FINRA By-Laws, Article V, Section 2(c). In the first instance, Goldman failed to file an amendment to Form U4 to disclose that Fabrice Tourre had received a "Wells Notice" from the Securities and Exchange Commission ("SEC") in connection with the agency's investigation of an offering of a synthetic collateralized debt obligation ("CDO") called Abacus 2007-AC I ("Abacus"). In the second instance, Goldman failed to

amend another employee's Form U4 to disclose that he had received a Wells Notice.

* * *

By reason of the foregoing, Goldman violated NASD Conduct Rule 3010 and FINRA Rule 2010.[5] **Goldman consents to the imposition of a censure and a fine of $650,000**, and an undertaking that it will certify that it has conducted a review of its procedures and systems concerning Form U4 amendments and compliance with FINRA By-Laws, Article V, Section 2(c) and implemented any necessary revisions.

Form U4 is used to register associated persons of broker-dealers with the appropriate jurisdiction(s) and/or self regulatory organization(s) ("SROs"). Disclosures made in response to the questions on Form U4 play a vital role in the securities industry. The disclosures are used to determine and monitor the fitness of securities professionals. Timely, truthful, and complete answers on Form U4 are essential to meaningful regulation.

104. The FINRA Settlement also details the fact that ***Goldman actively hid the Wells Notices from its Global Compliance division***. Senior executives and attorneys at Goldman had knowledge of the Tourre Wells Notice but ***treated the information as confidential and shared it only on a "need to know" basis***:

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[5] NASD Conduct Rule 3010 became FINRA Rule 2010 effective December 15, 2008.

Global Compliance is the Division within Goldman that advises and assists the Firm's businesses to ensure compliance with applicable laws and regulations. . . . Global Compliance Employee Services ("GCES") manages registrations, outside interests and private investments. The "Registrations Group" within GCES is responsible for filing initial Forms U4 and amendments thereto.

For GCES to fulfill its responsibility, other sources within Goldman must identify and communicate reportable events to GCES. In the two instances here, GCES was not timely informed of the Wells Notices. ***In the case of Tourre, knowledge that he had received a Wells Notice was limited to a small circle of people inside the firm, including certain senior staff and attorneys, who treated the information as confidential and shared it only on a "need to know" basis***. The fact that a Wells Notice had been received was not communicated to GCES, and Tourre's Form U4 was not timely amended.

The divisional compliance personnel embedded in the business units where Tourre worked in London (for GSI) and where the other individual worked in New York (for Goldman) were not informed when the firm learned about the Wells Notices.

* * *

By reason of the foregoing, Goldman violated NASD Conduct Rule 3010 and FINRA Rule 2010.

105. Goldman was also heavily fined by the United Kingdom's financial regulator, the FSA, for the same conduct – failing to disclose the Abacus-related Wells Notices. On September 9, 2010, the FSA announced the ***second largest fine in its history***, penalizing Goldman nearly $27 million for failing to disclose (a) the SEC's investigation, (b) the Goldman Wells Notice, and (c) the Tourre Wells Notice.

106. The FSA stated in its September 9, 2010 Final Notice of Penalty ("FSA Notice") its reasons for the substantial fine:

> The FSA imposes the financial penalty on GSI for breaches of Principles 2, 3 and 11 in relation to:
>
> (1) GSI's failure to inform the FSA, until 16 April 2010, that the staff of the United States Securities and Exchange Commission ("SEC") had indicated by a Wells Call on 28 September 2009 that it would serve, and then on 29 September 2009 served, a Wells Notice indicating the SEC staff's proposal to recommend an enforcement action for serious violations of US securities law by an approved person employed by GSI, Mr. Fabrice Tourre, relating to his prior activities when working in the US for Goldman, Sachs & Co. ("the Tourre Wells Notice");
>
> (2) GSI's failure to ensure that it had proper and effective systems and controls in place for the communication to GSI Compliance of information about regulatory investigations relating to other members of The Goldman Sachs Group, Inc. ("GS Group") that might affect GSI, as a result of which GSI failed to

consider providing the FSA with information concerning the SEC's investigation ("the SEC Investigation") into the Abacus 2007-AC1 synthetic collateralised debt obligation ("Abacus" or "the Abacus transaction"), which Goldman, Sachs & Co. ("GSC") structured and which was marketed to sophisticated institutional investors, including by GSI from the UK. ***This could have been considered from February 2009 when approved persons at GSI were called to give testimony to the SEC regarding Abacus and should have been considered at the latest in July 2009, when GSC received a Wells Notice from the SEC staff indicating the SEC staff's proposal to recommend an enforcement action against GSC for serious violations of US securities law relating to Abacus*** ("the GSC Wells Notice"); and

(3) GSI's failure to conduct its business with due skill, care and diligence with respect to its regulatory reporting obligations.

* * *

During the Relevant Period, GSI breached Principle 2 by failing to conduct its business with due skill, care and diligence in relation to its regulatory reporting obligations. Specifically, GSI failed to consider the regulatory implications for GSI of the SEC Investigation, including the GSC Wells Notice and the Tourre Wells Notice.

107. The FSA viewed Goldman's failings as "***particularly serious***" because, *inter alia*:

(2) Given GSI's sophistication and global operations and the operation of Goldman Sachs as an integrated global firm, it should have had in place systems and controls that were effective to ensure relevant information concerning the SEC Investigation (and the Wells Notices issued to GSC and Mr. Tourre) potentially affecting GSI was communicated appropriately and, in particular, to its compliance department to enable it to consider whether it needed to make appropriate notifications to the FSA;

(3) In particular, throughout the Relevant Period, there were ***a number of developments which either individually or cumulatively should have been brought to the attention of GSI's compliance function so that it could properly consider their impact on GSI's regulatory reporting obligations***. This, however, did not occur. These developments included the following:

(a) when (from February 2009) the SEC staff indicated its intention to interview and subsequently (in March and May 2009) took testimony from certain GSI employees, who were holders of FSA-approved functions, for the purposes of its investigation;

(b) when the SEC staff issued a Wells Notice to GSC in respect of the SEC staff's proposal to recommend an enforcement action for serious violations of US securities law relating to Abacus, which was marketed and sold by GSI from the

UK to sophisticated institutional investors (on 28 July 2009); and

(c) when the SEC staff indicated that it would recommend enforcement action against Mr. Tourre, a GSI employee and the holder of a controlled function, by a Wells Call on 28 September 2009 and subsequently issued a Wells Notice to Mr. Tourre indicating the SEC staff's proposal to recommend an enforcement action for serious violations of US securities law against him personally (on 29 September 2009);

(4) A number of ***senior managers*** and other GSI personnel, ***including approved persons, were aware of certain aspects of the SEC Investigation***, including that Mr. Tourre had received a Wells Notice containing allegations of serious securities violations, well before 16 April 2010, but took no steps to ensure that GSI Compliance was made aware. Whilst it was not in the circumstances unreasonable for those people to assume that the matter would be properly handled, the FSA is disappointed that none of them raised the matter directly with GSI Compliance.

108. The FSA Notice made clear that Goldman senior managers had knowledge of the key events:

> From July 2009 onwards, a number of ***senior managers within GSC were aware that a Wells Notice had been issued to GSC***. From September 2009, certain senior managers at GSI also became aware of the

> GSC Wells Notice in the context of being made aware of the Tourre Wells Notice (as set out below). It appears that none of these individuals, nor the personnel in New York who were managing or involved with GSC's engagement with the SEC Investigation, considered the potential impact of the GSC Wells Notice on GSI. Consequently, relevant information relating to the GSC Wells Notice was not communicated to GSI Compliance.

109. The FSA found that, "the seriousness of GSI's breach . . . merits a very substantial financial penalty."

110. Consistent with its failure to inform shareholders about the SEC's Abacus-related investigation, Goldman did not disclose that it had received a notice of investigation from either FINRA or FSA until May 10, 2010, after the market had absorbed the April 16, 2010 SEC Complaint.

E. Goldman's False and Misleading Statements and Omissions Post-Receipt of the Wells Notice in July 2009

111. The first category of false and misleading statements and omissions consists of those by Goldman starting on August 2, 2009 in which Goldman hid from its investors, and its domestic and international financial regulators, the Company's knowledge that the SEC had issued a Wells Notice recommending the filing of securities fraud charges. By failing to disclose the Wells Notice, Goldman hid its improper conduct of betting against (or allowing a favored client to bet against) the very toxic securities that Goldman designed to fail and packaged and sold to its clients.

1. The False and Misleading Statements in SEC Filings and Public Announcements from August 2, 2009 to November 10, 2009

112. On August 2, 2009, only two days after receiving the Wells Notice, Goldman filed its Second Quarter 2009 10-Q, which was signed by defendant Viniar and included certifications from defendants Blankfein and Viniar. In the Legal Proceedings Section of the 10-Q, Goldman listed numerous proceedings including a section titled "mortgage related matters," but concealed the existence of the SEC Wells Notice or the investigation into Abacus.

113. The Legal Proceedings section was represented to "amend[] our discussion set forth under Item 3 "Legal Proceedings" in our Annual Report on Form 10-K for the fiscal year ended November 28, 2008, as updated by our Quarterly Report on Form 10-Q for the quarter ended March 27, 2009." Regulation S-K Item 103 ("Legal Proceedings") requires the disclosure of "proceedings known to be contemplated by governmental authorities" and provides:

> Describe briefly any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the registrant or any of its subsidiaries is a party or of which any of their property is the subject. Include the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought. ***Include similar information as to any such proceedings known to be contemplated by governmental authorities***.

114. Goldman's August 2, 2009 10-Q was false and misleading and also violated Regulation S-K Item 103. Goldman knew that the SEC had recommended the filing of securities fraud charges, and thus knew that a securities fraud "legal proceeding" was being "contemplated by governmental authorities." Goldman's failure to disclose its receipt of the Wells Notice and SEC investigation prevented the public from discovering Goldman's fraudulent conduct, which when revealed on April 16, 2010 caused Goldman's stock to plummet, resulting in investors suffering billions in losses. The above statement was also materially false and misleading for the reasons stated in ¶¶49-112.

115. On October 15, 2009, Goldman issued a press release reporting its third quarter 2009 results, but again failed to disclose that it had received a Wells Notice or that it was under investigation by the SEC. The above statement was materially false and misleading for the reasons stated in ¶¶49-114 above.

116. The next day, October 16, 2009, Blankfein told reporters that: "Our business correlates with growth. Once it starts to turn, we get very involved in that process. We benefit from it. . . . Behind that investment is wealth creation and jobs." When asked about credit default swaps, Blankfein said, "I think they serve a real social purpose." Blankfein's statement was materially false and misleading because he purposefully concealed the fact that the SEC had already recommended the filing of securities fraud charges in the Abacus transaction, which involved credit default swaps.

117. Then in October 2009, when Goldman came under intense scrutiny about the more than $16 billion in bonuses it was scheduled to pay to Goldman's

executives and employees, the Company embarked on a full-fledged public relations campaign to promote its reputation as the preeminent Wall Street bank focused first and foremost on responsible business practice that placed their clients needs paramount to all else. This public relations blitz included highlighting that the Company made a $200 million donation to promote education, while at the same time concealing the Wells Notice, SEC investigation and Goldman's abusive conduct of making billions at the direct expense of its clients.

118. On November 4, 2009, Goldman filed its Third Quarter 2009 10-Q, which was signed by defendant Viniar and included certifications by defendants Blankfein and Viniar. The Form 10-Q included a section entitled "Legal Proceedings."[6] Goldman listed numerous legal proceedings and referenced the IPO litigation and other ongoing proceedings, such as the specialists litigation and treasury matters and mortgage-related matters, but omitted the SEC investigation and Wells Notice.

119. Goldman's Third Quarter 2009 10-Q was materially false and misleading and also violated Regulation S-K Item 103. Goldman knew that the SEC had recommended the filing of securities fraud charges, and thus knew that a securities fraud "legal proceeding" was being "contemplated by governmental authorities." Goldman's failure to disclose its receipt of the Wells Notice and SEC investigation prevented the

[6] The Legal Proceedings section was represented to "amend[] our discussion set forth under Item 3 "Legal Proceedings" in our Annual Report on Form 10-K for the fiscal year ended November 28, 2008, as updated by our Quarterly Reports on Form 10-Q for the quarters ended March 27, 2009 and June 26, 2009."

public from discovering Goldman's fraudulent conduct, which when revealed on April 16, 2010 caused Goldman's stock to plummet, resulting in investors suffering billions in losses. The above statements were also materially false and misleading for the reasons stated in ¶¶49-117.

120. Only four days later, on November 8, 2009, the *Sunday Times* in London published an extensive interview with Blankfein which stated in part:

> We're very important . . . . We help companies to grow by helping them to raise capital. Companies that grow create wealth. This, in turn, allows people to have jobs that create more growth and more wealth. It's a virtuous cycle. . . . We have a social purpose.
>
> * * *
>
> Call him what you will. He is, [Blankfein] says, just a banker "doing God's work."

121. On November 10, 2009, CEO Blankfein spoke at the Bank of America/Merrill Lynch Banking Financial Services Conferences and hid from investors Goldman's knowledge of the SEC's intent to recommend fraud charges against the Company for its fraudulent conduct of betting against its clients. To the complete contrary, Blankfein highlighted that Goldman's reputation and past and continued commitment to its clients was, and remained, the key to Goldman's success:

> During our history, ***our Firm has been guided by three tenets – the needs and objectives of our clients***, attracting talented and long-term oriented people, ***and our reputation and client franchise***.

* * *

> [O]ur duty to shareholders, is to protect and grow ***this client franchise that is the lifeblood of Goldman Sachs***.

122. Blankfein's statements were materially false and misleading. He failed to disclose Goldman's receipt of the Wells Notice and the SEC investigation, which would have revealed Goldman's fraudulent conduct of subjugating its clients' interests below that of the Company, including, that Goldman had (i) identified toxic mortgage-backed securities and CDOs held on its books that Goldman believed would significantly decline in value and cause the firm to lose billions; (ii) packaged and sold these securities to Goldman's own clients at inflated prices; (iii) made affirmative misrepresentations to its own clients in order to hide the fact that Goldman (or a favored client) had bet against these securities; and (iv) made billions at its own clients' expense when the value of these securities plummeted, just as Goldman anticipated they would. The above statements were also materially false and misleading for the reasons stated in ¶¶49-120.

2. The False and Misleading Statements in Response to the *New York Times* Article

123. On December, 24, 2009, the *New York Times* disclosed that Goldman had created and sold mortgage related debts in CDOs, bet against these securities and made billions. The article referenced Goldman's series of Abacus CDOs and the Hudson CDO, but did not disclose Goldman's fraudulent conduct in connection with those securities.

124. On that same day, Goldman immediately issued a public denial defending its CDO practices as necessary to meet “client demand,” all the while again hiding the fact that the SEC had already notified the Company that it intended to recommend securities fraud charges arising from its role in the Abacus deal. Goldman’s press release stated:

> Background: The New York Times published a story on December 24th primarily focused on the synthetic collateralized debt obligation business of Goldman Sachs. In response to questions from the paper prior to publication, Goldman Sachs made the following points.
>
> As reporters and commentators examine some of the aspects of the financial crisis, interest has gravitated toward a variety of products associated with the mortgage market. One of these products is synthetic collateralized debt obligations (CDOs), which are referred to as synthetic because the underlying credit exposure is taken via credit default swaps rather than by physically owning assets or securities. The following points provide a summary of how these products worked and why they were created.
>
> Any discussion of Goldman Sachs’ association with this product must begin with our overall activities in the mortgage market. Goldman Sachs, like other financial institutions, suffered significant losses in its residential mortgage portfolio due to the deterioration of the housing market (we disclosed $1.7 billion in residential mortgage exposure write-downs in 2008). These losses would have been substantially higher had we

not hedged. We consider hedging the cornerstone of prudent risk management.

Synthetic CDOs were an established product for corporate credit risk as early as 2002. With the introduction of credit default swaps referencing mortgage products in 2004-2005, it is not surprising that market participants would consider synthetic CDOs in the context of mortgages. Although precise tallies of synthetic CDO issuance are not readily available, many observers would agree the market size was in the hundreds of billions of dollars.

Many of the synthetic CDOs arranged were the result of demand from investing clients seeking long exposure.

Synthetic CDOs were popular with many investors prior to the financial crisis because they gave investors the ability to work with banks to design tailored securities which met their particular criteria, whether it be ratings, leverage or other aspects of the transaction.

The buyers of synthetic mortgage CDOs were large, sophisticated investors. These investors had significant in-house research staff to analyze portfolios and structures and to suggest modifications. They did not rely upon the issuing banks in making their investment decisions.

For static synthetic CDOs, reference portfolios were fully disclosed. Therefore, potential buyers could simply decide not to

> participate if they did not like some or all the securities referenced in a particular portfolio.
>
> Synthetic CDOs require one party to be long the risk and the other to be short so without the short position, a transaction could not take place.
>
> It is fully disclosed and well known to investors that banks that arranged synthetic CDOs took the initial short position and that these positions could either have been applied as hedges against other risk positions or covered via trades with other investors.
>
> Most major banks had similar businesses in synthetic mortgage CDOs.
>
> As housing price growth slowed and then turned negative, the disruption in the mortgage market resulted in synthetic CDO losses for many investors and financial institutions, including Goldman Sachs, effectively putting an end to this market.

125. Goldman's false and misleading press release had its intended effect of negating any impact from the *New York Times* article. As a result, Goldman stock traded up that day, closing at $163.97 up from $163.63 the prior day.

126. The above statements were materially false and misleading because they failed to disclose Goldman's receipt of the Wells Notice and the SEC investigation, which would have revealed Goldman's fraudulent conduct of subjugating its clients' interests below that of the Company; including that Goldman had (i) identified toxic mortgage-backed securities and CDOs held on its books that Goldman believed would

significantly decline in value and cause the firm to lose billions; (ii) packaged and sold these securities to Goldman's own clients at inflated prices; (iii) made affirmative misrepresentations to its own clients in order to hide the fact that Goldman had bet against these securities; and (iv) made billions at its own clients' expense when the value of these securities plummeted, just as Goldman anticipated they would. The above statements were also materially false and misleading for the reasons stated in ¶¶49-125.

3. The False and Misleading Statements in SEC Filings from January 21, 2010 to March 1, 2010

127. On January 21, 2010, Goldman reported its fourth quarter and year end December 31, 2009 results in a press release which emphasized the Company's commitment to its clients:

> Throughout the year, particularly during the most difficult conditions, Goldman Sachs was an active adviser, market maker and asset manager for our clients," said Lloyd C. Blankfein, Chairman and Chief Executive Officer. "Our strong client franchise across global capital markets, along with the commitment and dedication of our people drove our strong performance. That performance, as well as recognition of the broader environment, resulted in our lowest ever compensation to net revenues ratio. Despite significant economic headwinds, we are seeing signs of growth and remain focused on supporting that growth by helping companies raise capital and manage their

> risks, by providing liquidity to markets and by investing for our clients.

The above statement was materially false and misleading for the reasons stated in ¶¶49-126, 148-306.

128. On or about March 1, 2010, Goldman filed its Form 10-K for the year ended December 31, 2009, signed by Defendants Blankfein, Viniar and Cohn, which emphasized Goldman's client focus:

> In our client-driven businesses, FICC [Fixed Income, Currency and Commodities] and Equities strive to deliver high-quality service by offering broad market-making and market knowledge to our clients on a global basis. In addition, we use our expertise to take positions in markets, by committing capital and taking risk, to facilitate client transactions and to provide liquidity. Our willingness to make markets, commit capital and take risk in a broad range of fixed income, currency, commodity and equity products and their derivatives is crucial to our client relationships and to support our underwriting business by providing secondary market liquidity.

129. Goldman did not disclose the SEC investigation and Wells Notice in its 2009 Form 10-K. Instead, it vaguely mentioned that there are some unknown "investigations presently under way," and that it had received "requests" from "various governmental agencies." In the preamble to the Legal Proceedings section of its 2009 Form 10-K, Goldman stated:

> We are involved in a number of judicial, regulatory and arbitration proceedings (including those described below) concerning matters arising in connection with the conduct of our businesses. We believe, ***based on currently available information***, that the results of such proceedings, in the aggregate, ***will not have a material adverse effect on our financial condition***, but might be material to our operating results for any particular period, depending, in part, upon the operating results for such period. Given the range of litigation and investigations presently under way, our litigation expense can be expected to remain high.

Then, despite the ten pages reporting Goldman's legal proceedings, in the subsection reporting Mortgage-Related Matters, Goldman stated only that:

> GS&Co. and certain of its affiliates, together with other financial services firms, have received ***requests for information from various governmental agencies*** and self-regulatory organizations relating to subprime mortgages, and securitizations, collateralized debt obligations and synthetic products related to subprime mortgages. GS&Co. and its affiliates are cooperating with the requests.

The Form 10-K also mentioned certain "inquiries" into derivatives:

> *Credit Derivatives*
>
> Group Inc. and certain of its affiliates have received inquiries from various governmental

> agencies and self-regulatory organizations regarding credit derivative instruments. The firm is cooperating with the requests.

130. The above statements were materially false and misleading and also violated Regulation S-K Item 103. Goldman knew that the SEC had recommended the filing of securities fraud charges, and thus knew that a securities fraud "legal proceeding" was being "contemplated by governmental authorities." Goldman's failure to disclose its receipt of the Wells Notice and SEC investigation prevented the public from discovering Goldman's fraudulent conduct, which, when revealed on April 16, 2010, caused Goldman's stock to plummet, resulting in investors suffering billions in losses. The above statements were also materially false and misleading for the reasons stated in ¶¶49-127.

131. As set forth in Section X, Goldman's materially false and misleading statements and omissions caused Goldman's stock to trade at artificially inflated levels during the Class Period. When the SEC filed its securities fraud complaint against Goldman on April 16, 2010, the market finally learned that, contrary to Goldman's public representations, the Company had known that since late July 2009 that the SEC intended to bring formal securities fraud charges based on Goldman's conduct in connection with Abacus. Goldman's stock plummeted from $184.27 to $160.70 per share, causing over a $13 billion loss in shareholder value.

VII. FACTS SUPPORTING DEFENDANTS' FALSE AND MATERIAL MISSTATEMENTS AND OMISSIONS AND SCIENTER CONCERNING THEIR IMPROPER BUSINESS PRACTICES AND CLIENT CONFLICTS OF INTEREST RELATED TO ABACUS

132. The second category of false and misleading statements consists of those by Goldman beginning on February 5, 2007, when Goldman filed its Form 10-K for the fiscal year ended November 24, 2006, in which it reassured investors that it had extensive procedures and controls to avoid conflicts of interest with and among its clients. At the same time, Goldman hid from its clients, investors, and its domestic and international regulators, the Company's improper business practices with respect to Abacus, including that Goldman had deliberately created client conflicts of interest by designing the Abacus deal from the outset to allow the Paulson hedge fund to short more than $1 billion worth of Abacus securities at the direct expense of its other clients to whom Goldman made false representations while recommending and selling those same securities.

133. Goldman repeatedly made specific statements and omissions in its SEC filings indicating that its undisclosed fraudulent conduct was not occurring – when in fact it was. Goldman warned its shareholders about the dangers posed by client conflicts of interest – all while the omitting the fact that the Company was engaged in pervasive conflicts of interest by selling its clients securities that were designed to fail and profiting at their clients' expense.

134. In its Form 10-Ks throughout the Class Period, Goldman repeatedly reassured its shareholders that it

had "extensive procedures and controls that are designed to [identify and] address conflicts of interest." Goldman's Form 10-Ks for 2006 and 2007 filed on February 6, 2007 and January 29, 2008, respectively, stated:

> Conflicts of interest are increasing and a failure to appropriately deal with conflicts of interest could adversely affect our businesses.
>
> Our reputation is one of our most important assets. ***As we have expanded the scope of our businesses and our client base, we increasingly have to address potential conflicts of interest, including situations where our services to a particular client or our own proprietary investments or other interests conflict, or are perceived to conflict, with the interests of another client*** . . . .
>
> * * *
>
> ***We have extensive procedures and controls that are designed to [identify and] address conflicts of interest***, including those designed to prevent the improper sharing of information among our businesses. However, appropriately [identifying and] dealing with conflicts of interest is complex and difficult, and our reputation could be damaged and the willingness of clients to enter into transactions in which such a conflict might arise may be affected if we fail, or appear to fail, to [identify and] deal appropriately with conflicts of interest. ***In addition, potential***

> ***or perceived conflicts could give rise to litigation or enforcement actions***.

135. Goldman's Form 10-Ks for 2008, 2009, and 2010 filed on January 27, 2009, February 26, 2010 and February 28, 2011, respectively, stated:

> Conflicts of interest are increasing and a failure to appropriately deal with conflicts of interest could adversely affect our businesses.
>
> * * *
>
> ***We have extensive procedures and controls that are designed to identify and address conflicts of interest***, including those designed to prevent the improper sharing of information among our businesses. However, appropriately identifying and dealing with conflicts of interest is complex and difficult, and our reputation, which is one of our most important assets, could be damaged and the willingness of clients to enter into transactions [with us] may be affected if we fail, or appear to fail, to identify, [disclose] and deal appropriately with conflicts of interest. ***In addition, potential or perceived conflicts could give rise to litigation or [regulatory] enforcement actions***.

136. Indeed, Goldman specifically identified the precise risks posed by client conflicts of interest that subsequently materialized when Goldman was sued by the SEC. Goldman stated in each of its Form 10-Ks during the Class Period that "conflicts could give rise to ***litigation or [regulatory[enforcement actions***." However, Goldman, in these same filings, reassured investors by stating that "***[w]e have extensive***

procedures and controls that are designed to [identify and] address conflicts of interest . . . ."

137. Goldman's warnings to shareholders regarding potential conflicts of interest omitted the fact that it was aware of the existence of such conflicts at the time. Unbeknownst to Goldman's clients and shareholders, at the behest of Goldman senior management, Goldman had designed the Abacus deal from the outset to allow the Paulson hedge fund to short more than $1 billion worth of Abacus securities at the direct expense of its other clients to whom it had recommended and sold those same securities.

138. The above statements were materially false and misleading because they failed to disclose that Goldman had deliberately created ***actual*** conflicts of interest by engaging in transactions that were designed from the outset by the Company to allow a favored client to benefit at the expense of its other clients. The above statements were also materially false and misleading because they failed to disclose defendants' improper conduct with respect to Abacus.

139. As discussed in Section VI.E.2., *supra*, on December, 24, 2009, the *New York Times* disclosed Goldman's role in creating and selling the Abacus securities, and Paulson's short position, but did not disclose Goldman's fraudulent conduct with respect to Abacus.

140. On that same day, Goldman immediately issued a public denial defending its CDO practices as necessary to meet "demand from investing clients seeking long exposure."

141. As alleged in Section VI.E.2., *supra*, and alleged here as a separate misrepresentation, Goldman's statement that its CDO practices were

necessary to meet "client demand" was materially false and misleading because it failed to disclose Goldman's improper business practices in designing the Abacus deal from the outset in order to allow a favored client to benefit at the expense of its other clients. Specifically, defendants failed to disclose that Goldman had designed the Abacus deal to allow the Paulson hedge fund to short more than $1 billion worth of Abacus securities at the direct expense of its other clients to whom it made false representations while recommending and selling to them those same securities.

142. These statements were also materially false and misleading for the reasons stated in ¶¶49-141 above.

143. A reasonable investor would have viewed the Company's improper conduct in Abacus and the Company's deliberate conflict of interests with its clients in Abacus as significant, material information in making an investment decision.

144. As previously noted, on April 16, 2010, the SEC filed a complaint charging Goldman with securities fraud in connection with the Abacus deal. In July 2010, Goldman settled that case for ***$550 million***, the largest SEC penalty in history, and admitted that:

> [T]he marketing materials for the ABACUS 2007-AC1 transaction contained incomplete information. In particular, it was a mistake for the Goldman marketing materials to state that the reference portfolio was 'selected by' ACA Management LLC without disclosing the role of Paulson & Co. Inc. in the portfolio selection process and that Paulson's economic interests were adverse to CDO investors.

145. In addition, on June 10, 2011, Judge Barbara S. Jones issued an opinion denying in part Tourre's motion to dismiss the SEC's complaint against him based on the Abacus deal. Judge Jones held that the SEC had adequately pled "all of the elements of a Section 10(b) and Rule 10b-5 violation," reasoning:

> Here, having allegedly affirmatively represented Paulson had a particular investment interest in ABACUS—that it was long—in order to both accurate and complete . . . , Goldman and Tourre had a duty to disclose Paulson had a different investment interest—that it was short. . . . Indeed, the crux of the SEC's allegation is that rather than being financially interested in ABACUS's success, as the SEC alleges Tourre represented to ACA . . . , Paulson, in fact, had financial interests and expectations that were diametrically opposed to ABACUS's success.

SEC v. Tourre, No. 10 Civ. 3229, 2011 WL 2305988, at *13 (S.D.N.Y. June 10, 2011) (internal quotations and citations omitted).

146. ACA has also sued Goldman in New York state court, asserting state law claims for fraudulent inducement, fraudulent concealment and unjust enrichment against the Company.

147. As set forth in Section X, Goldman's materially false and misleading statements and omissions caused Goldman's stock to trade at artificially inflated levels during the Class Period. When the SEC filed its securities fraud complaint against Goldman on April 16, 2010, the market finally learned that, contrary to Goldman's public representations regarding its business practices, the Company had deliberately

created ***actual*** conflicts of interest by engaging in the Abacus transaction that was designed from the outset by the Company to allow a favored client to benefit at the expense of Goldman's other clients. In response, Goldman's stock plummeted from $184.27 to $160.70 per share, causing over a $13 billion loss in shareholder value.

VIII. FACTS SUPPORTING DEFENDANTS' FALSE AND MATERIAL MISSTATEMENTS AND OMISSIONS AND SCIENTER REGARDING GOLDMAN'S FAILURE TO DISCLOSE ITS CONFLICTS OF INTEREST WITH ITS CLIENTS AND THE IMPACT ON GOLDMAN'S CLIENT FRANCHISE AND REPUTATION

148. In addition to Abacus, the Senate Subcommittee identified Hudson Mezzanine Funding 2006-1 ("Hudson"), Anderson Mezzanine Funding 2007-1 ("Anderson") and Timberwolf I ("Timberwolf") as other Goldman CDOs in Fall 2006 through Summer of 2007, in which the Company engaged in clear conflicts of interest by packaging and selling poor quality mortgage-related securities, that were likely to lose value, to its clients at higher prices than the Company believed they were worth, and betting against those very securities – thereby allowing the Company to reap billions in profits at their clients' direct expense.

149. The third category of false and misleading statements and omissions consist of those made by Goldman beginning in February 2007 in which the Company repeatedly told the public that its "best in class" franchise and continued success depended on the Company's reputation, honesty, integrity and

commitment to put its clients' interests first above all else. These statements failed to disclose Goldman's clear conflicts of interest with its own clients in connection with the Abacus, Hudson, Anderson and Timberwolf CDOs, whereby Goldman intentionally packaged and sold billions of these securities that were designed to fail to its clients, while at the same time reaping billions for itself or its favored clients by taking massive short positions on these securities.

150. During the Class Period, market analysts incorporated the value of Goldman's "best in class" franchise, reputation and purported commitment to its clients above all else into their estimates of revenues, earnings and stock price, without knowledge that Goldman profited handsomely by betting against its own clients. Had Goldman disclosed these material facts, it would have suffered the severe damage to its franchise, reputation and stock price that it ultimately suffered when the truth was revealed between April 16, 2010 and June 2010.

A. Goldman's Financial Success Has Been Driven by Its Reputation, Client Franchise and Commitment to Put Its Clients First Above All Else

151. Goldman has been in existence since 1869, serving as a private investment bank, publicly traded corporation and now bank holding company. The Company manages almost a trillion in assets. Between 2007 and 2010 Goldman recorded a collective profit of over $35 billion.

152. The key to Goldman's success and survival for 140 years has been its name and its reputation for placing its clients' interests paramount above all else. As reported by the *New York Times*, "during the Great

Depression, Goldman was caught up in a scandal involving the Goldman Sachs Trading Corporation. The taint of the scandal drove away business for more than a decade and made the firm extremely focused on reputation."

153. The Company has repeatedly publicly stressed and highlighted its "best in class" franchise and reputation and commitment to its clients, including during the Class Period. At the very same time, Goldman purposefully concealed that it had sold toxic CDOs to its clients to reap huge profits at those clients' expense, and that the SEC had notified Goldman of its recommendation to file securities fraud charges relating to Abacus.

154. Goldman's statements include:

- <u>Goldman CEO Blankfein Statements at November 10, 2009 Bank of America/Merrill Lynch Banking Financial Services Conference</u>

  During our history, ***our Firm has been guided by three tenets – the needs and objectives of our clients***, attracting talented and long-term oriented people, ***and our reputation and client franchise***.

  * * *

  [O]ur duty to shareholders, is to protect and grow ***this client franchise that is the lifeblood of Goldman Sachs***.

- <u>Goldman CEO Blankfein Statements at November 13, 2007 Merrill Lynch Banking and Financial Investor Conference</u>

What drove performance was the quality of our client franchise. To me, franchise describes the extent to which ***our clients come to us for help, advice, and execution. From those relationships, business opportunities are brought to the firm***.

- Goldman CFO Viniar June 14, 2007 Statements on Goldman's 2d Quarter Investor Conference Call

  Most importantly, and the basic reason for our success, is our extraordinary focus on our clients.

- Goldman's Annual Report (each year from 2006-2010)

- Goldman Business Principles

  1 ***Our clients' interests always come first***. Our experience shows that if we serve our clients well, our own success will follow.

  2 Our assets are our people, capital and ***reputation. If any of these is ever diminished, the last is the most difficult to restore***. ***We are dedicated to complying fully with the letter and spirit of the laws, rules and ethical principles that govern us***. ***Our continued success depends upon unswerving adherence to this standard***.

* * *

14 ***Integrity and honesty are at the heart of our business***.

- Goldman's Form 10-Ks

Conflicts of interest are increasing and a failure to appropriately deal with conflicts of interest could adversely affect our businesses.

Our reputation is one of our most important assets. As we have expanded the scope of our businesses and our client base, we increasingly have to address potential conflicts of interest, ***including situations where our services to a particular client or our own proprietary investments or other interests conflict, or are perceived to conflict, with the interests of another client***, as well as situations where one or more of our businesses have access to material non-public information that may not be shared with other businesses within the firm.

* * *

We have extensive procedures and controls that are designed to address conflicts of interest, including those designed to prevent the improper sharing of information among our businesses. However, appropriately identifying and dealing with conflicts of interest is complex and difficult, and our reputation, which is one of our most important assets, could be damaged and the willingness of clients to enter into transactions in which such a conflict might arise may be affected if we fail, or appear to fail, to identify and deal appropriately with conflicts of interest. In addition, potential or perceived conflicts could give rise to litigation or enforcement actions.

* * *

Trading and Principal Investments[7]

* * *

We believe our willingness and ability to take risk to facilitate client transactions distinguishes us from many of our competitors and substantially enhances our client relationships.

* * *

We generate trading net revenues from our ***client [or customer]-driven*** businesses in three ways:

- First, in large, highly liquid markets, we undertake a high volume of transactions for modest spreads and fees.

[7] Goldman's Trading and Principal Investments segment is divided into three components: Fixed Income, Currency and Commodities ("FICC"); Equities; and Principal Investments. FICC has five principal businesses: commodities; credit products; currencies; interest rate products, including money market instruments; and mortgage-related securities and loan products and other asset-backed instruments. The Goldman employees that did the relevant deals were part of the mortgage business section.

- Second, by capitalizing on our strong relationships and capital position, we undertake transactions in less liquid markets where spreads and fees are generally larger.
- Finally, we structure and execute transactions that address complex ***client needs***.

155. Indeed, Goldman continued to admit that its reputation, client franchise and commitment to its clients above all else was the key to the Company's success:

- Goldman CEO Blankfein April 27, 2010 Testimony Before Congress

  We have been a client-centered firm for 140 years and ***if our clients believe that we don't deserve their trust we cannot survive***.

156. The investment community has consistently recognized that Goldman's past and continued success as the preeminent Wall Street investment bank is undeniably tied to its reputation, client franchise and purported commitment to its clients:

April 11, 2007 Deutsche Bank Analyst Report

Goldman Sachs is set apart by its best-in-class franchise.

* * *

Reputation – the bar is higher: ***Because the firm probably benefits more from its reputation than any of its peers, it is also more vulnerable to high profile blow-ups***. A company lawyer speaks to employees each year and says that each person has the potential to do more harm than good, in an effort to remind all of ***how much is at stake with the firm's reputation***.

August 8, 2007 CIBC World Markets

"***In the end, all you have is your word, your name, and your reputation,***" *is what my granny would often say. Goldman Sachs operates from the same playbook,* ***a point that cannot be overemphasized and what we believe to be the key to understanding Goldman Sachs***.

Reputation is everything when entering into a new market. Goldman's reputation is such that it has garnered it the most coveted sovereign relationships from China to the Middle East and beyond. . . . Due to this, we believe Goldman will dominate market share in this region for years to come.

November 28, 2007 CIBC World Markets

[W]e met with CFO David Viniar, Head of IB David Solomon, and Co-President Gary Cohn at Goldman Sachs headquarters. ***Common to each meeting was the theme of communication amongst the organization and with clients. For this, GS maintains and grows its dominant market share.***

The message was direct: know what is going on everywhere inside GS at all times, manage risk, and ***put the client first in service***.

157. In fact, as subprime mortgage backed securities and CDOs experienced drastic declines from summer 2007-2009, and Goldman's competitors took billions in mortgage-related writedowns, the investment community stressed that Goldman's reputation for acting in the best interest of its clients would – and did in fact allow – the Company to not only withstand, but in fact profit, from the subprime meltdown:

> <u>November 28, 2007 CIBC World Markets Research Analyst Report</u>
>
> ***Goldman's third quarter results stood out by a mile from many of its peers who took billions of dollars in credit writedowns. Was this a fluke? Each manager yesterday spoke to the value of Goldman's franchise specific to customer relationships when characterizing the third quarter***. While many investors focus on GS's bet being "short" mortgages, management stated that had GS earned half what it did in mortgages during the third quarter, results would not have differed materially. ***The true strength of the quarter as viewed by management was in what Gary Cohn described as "one call" transactions, deals in which Goldman was brought in as the sole advisor due to its reputation as a "can do" firm***. These transactions include Countrywide, Home Depot, and the Bank of England for Northern Rock. Client trading worked much in the same way as Goldman gained market share from its clients understanding that if a deal

had any chance of getting done, Goldman could do it.

<u>September 18, 2008 HSBC Global Research Analyst Report</u>

We have long held the opinion that much of the world worships at the altar of Goldman. Rating agencies, equity investors, debt investors, and political officials all seem to ***hold the institution in higher regard than any of its competitors***. Its performance through the first stage of the credit bubble unwind reinforced those views.

<u>June 4, 2009 Bernstein Research Analyst Report</u>

[W]e believe Goldman Sachs will be the ultimate winner during a FICC [Fixed Income Currency and Commodities] recovery as GS is unrelenting in maintaining its reputation as the largest, most successful institutional trading firm on Wall Street and will continue to seize "up for grabs" market share and take advantage of credit market opportunities.

* * *

Risks

The biggest risk to any major broker-dealer is a loss of confidence in its name in the markets.

B. Goldman's Undisclosed Fraudulent Conduct in 2006-2007 in Connection with the Hudson, Anderson and Timberwolf CDOs

158. At the end of 2006 and throughout 2007, Goldman's senior management made a firm-wide decision to put Goldman's interests ahead of its own clients. Seeking to avoid the impending economic downturn which led to the collapse of some of Goldman's competitors, including Bear Stearns and Lehman Brothers, Goldman unloaded billions of dollars of deteriorating toxic assets off its books and onto its own clients. In addition to Abacus, the three CDO transactions detailed below demonstrate Goldman's fraudulent conduct in which Goldman took a substantial portion of the short side of each CDO, betting that the assets within the CDO would fall in value or not perform. Goldman's short position was in direct opposition to the clients to whom it sold the CDO securities, yet Goldman failed to disclose that it had designed these deals to fail, and that it took massive short positions to allow the Company to rid itself of mortgage related assets on its books and profit handsomely.

1. Hudson CDO

159. By mid-2006, Goldman's Mortgage Department had a predominantly pessimistic view of the U.S. subprime mortgage market. According to Michael Swenson, head of the Mortgage Department's Structured Products Group: "[D]uring the early summer of 2006 it was clear that the market fundamentals in subprime and the highly levered nature of CDOs [were] going to have a very unhappy ending."

160. By August 2006, Goldman management had decided that the upside for RMBS and CDOs linked to the ABX Index[8] had "run its course," and directed the Mortgage Department's Asset Backed Securities ("ABS") Desk to sell off its billions of dollars of ABX long holdings that Goldman accumulated throughout 2005 and 2006. After several weeks of effort, however, the ABS Desk was unable to find many buyers, and its ABX assets referencing mezzanine subprime RMBS securities, which were dropping in value, were losing hundreds of millions and began to pose a disproportionate risk to both Goldman's Mortgage Department and the firm as a whole.

161. In September 2006 Mortgage Department head Daniel Sparks and his superior, Jonathan Sobel, initiated a series of meetings with Swenson, head of the Structured Products Group ("SPG"), and Birnbaum, the Mortgage Department's top trader in ABX assets, to discuss the Department's long mortgage-related securities holdings. In those meetings, they discussed whether the Asset Backed Security (ABS) Trading Desk within SPG should get out of its existing positions or "double down."

162. In simple terms, if the Mortgage Department's existing long positions could be transferred off SPG's books by finding a "structured place to go with the risk," the ABS Trading Desk would then be free to "double down" by taking on new positions and risk.

163. That same month, September 2006, the ABS and CDO Desks reached agreement on constructing a

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[8] The ABX index is a key point of reference for securities backed by home loans issued to borrowers with weak credit. The index is comprised of a series of credit-default swaps based on 20 bonds that consist of subprime mortgages.

new CDO to provide the ABS Desk with a "structured exit" from some of its existing investments. The CDO was called Hudson Mezzanine Funding 2006-1. Goldman designed Hudson from its inception as a way to transfer the risk of loss associated with assets from Goldman's inventory to the Goldman clients that invested in Hudson. In fact, Goldman admitted to the Senate that Hudson was "initiated by the firm as the most efficient method to reduce long ABX exposures," and was an "exit for our long ABX risk."

164. Hudson was a $2 billion static synthetic CDO that was structured and began to be marketed by Goldman in or around late 2006. The actual offering of the Hudson CDO securities commenced on or about December 5, 2006, and was led by Goldman employees, Peter Ostrem (who headed the desk that originated CDOs for Goldman) and Darryl Herrick ("Herrick") (who eventually became the Hudson deal captain).

165. Goldman used the Hudson CDO to short $1.2 billion in ABX Index assets from Goldman's own inventory and to short another $800 million in single name CDS contracts referencing subprime RMBS securities. By holding 100% of the short position at the same time it solicited clients to buy the Hudson securities, Goldman created and hid an egregious conflict of interest with its clients.

166. The Hudson transaction allowed Goldman to profit directly from its clients' losses – while misleading those clients about the source of the reference assets and Goldman's position on the short side. When the Hudson securities declined in value, Goldman made a $1.35 billion profit on its proprietary short position at the expense of the clients to whom it had sold the Hudson securities.

167. According to Goldman's contemporaneous records and its responses to Senate Subcommittee questions, 100% of the CDS contracts included in Hudson were supplied by Goldman's Mortgage Department. Because Hudson contained only CDS contracts, it was entirely "synthetic"; it contained no loan pools or RMBS securities that directed actual cash payments to the CDO. Instead, the only cash payments made to Hudson consisted of the cash paid by investors making initial purchases of the Hudson securities and the premiums that Goldman paid into Hudson as the sole short party.

168. After establishing its basic characteristics and selecting the CDS assets to be included in Hudson, Goldman began to look for investors. A key development took place early on, when near the end of September 2006, Morgan Stanley's proprietary trading desk committed to entering into a CDS agreement with Goldman referencing the "super senior" portion of Hudson, meaning the CDO's lowest risk tranche that would be the first to receive payments to the CDO." Morgan Stanley agreed to take the long side of a CDS that represented $1.2 billion of the $2 billion CDO. Goldman failed to disclose the fact that it would be the sole short party in the entire $2 billion CDO.

169. After getting the commitment from Morgan Stanley, Goldman turned its focus to selling the remaining Hudson securities. Goldman's CDO marketing strategy typically involved its sales personnel sending clients a marketing booklet outlining different features of a particular CDO. Herrick drafted the marketing booklet for Hudson, and circulated it for review to Ostrem and other members of the CDO Origination Desk including

Benjamin Case and Matthew Bieber. The executive summary of the marketing booklet described Goldman's Hudson CDO program generally and Hudson Mezzanine Funding 2006-1 in particular:

> Goldman Sachs developed the Hudson CDO program in 2006 to create a consistent, programmatic approach to invest in attractive relative value opportunities in the RMBS and structured product market[.]
>
> * * *
>
> Goldman Sachs has aligned incentives with the Hudson program by investing in a portion of equity and playing the ongoing role of Liquidation Agent.

170. The marketing booklet also described the Hudson assets, and the selection process for those assets:

> The portfolio composition of Hudson Mezzanine Funding 2006-1 will consist of 100% CDS on RMBS.
>
> – 60% of the RMBS will be single name CDS on all 40 obligors in ABX 2006-1 and ABX 2006-2.
>
> – 40% of the RMBS will consist of single name CDS on 2005 and 2006 vintage RMBS . . .
>
> Goldman Sachs' portfolio selection process:
>
> – Assets sourced from the Street. Hudson Mezzanine Funding is not a Balance Sheet CDO
>
> – Goldman Sachs CDO desk pre-screens and evaluates assets for portfolio suitability

> – Goldman Sachs CDO desk reviews individual assets in conjunction with respective mortgage trading desks (Subprime, Midprime, Prime, etc.) and makes decision to add or decline[.]

171. Goldman's statement that "Goldman Sachs has aligned incentives with the Hudson program by investing in a portion of equity," was false and misleading. Goldman did, in fact, purchase approximately $6 million in Hudson equity. However, that $6 million equity investment was outweighed 300 times over by Goldman's $2 billion short position in Hudson, which made Goldman's interest adverse to, rather than aligned with, the Hudson investors. Neither the marketing booklet nor other offering materials disclosed to investors the size or nature of Goldman's short position in Hudson.

172. The marketing booklet also stated that Hudson's assets were "sourced from the Street," and that it was "not a Balance Sheet CDO," even though all of the CDS contracts had been produced and priced internally by Goldman and $1.2 billion of the contracts offset Goldman ABX holdings. The plain meaning of the phrase, "sourced from the Street," is that the Hudson assets were purchased from several broker-dealers on Wall Street.

173. The Senate Subcommittee asked several Goldman employees involved in Hudson to explain their understanding of the phrase:

(a) A former Goldman salesperson, Andrew Davilman, who sold Hudson securities to investors, told the Senate Subcommittee that he thought "sourced from the Street" referred to ***assets being acquired from a variety of different broker-***

dealers at the best prices, and was surprised to learn that all of the Hudson assets had been provided by Goldman's ABS Desk;

(b) Herrick, who drafted the Hudson marketing booklet, stated that "sourced from the Street" meant the assets were "***sourced from a street dealer at street prices***";

(c) Ostrem stated that "sourced from the Street" referred to the fact the ***underlying RMBS securities were not originated or underwritten by Goldman***; and

(d) Deeb Salem, a Goldman mortgage trader who selected 40% of the assets in Hudson, described "the Street" as simply "***short hand for all broker-dealers***."

174. By using the phrase, "sourced from the Street," Goldman misled investors into thinking that the referenced assets had been purchased from several broker-dealers and obtained at arms-length prices, rather than simply taken directly from Goldman's inventory and priced by its own personnel. Moreover, this phrase hides the fact that Goldman had an adverse interest to investors and was seeking to transfer unwanted risk from its own inventory to the clients it was soliciting. By claiming it was "not a Balance Sheet CDO," Goldman also misled investors into believing that Goldman had little interest in the performance of the referenced assets in Hudson, rather than having selected the assets to offset risks on its own books.

175. In addition to the Hudson marketing booklet, in December 2006, Goldman issued an Offering Circular which it distributed to potential investors. The Offering Circular contained the statement that no

independent third party had reviewed the prices at which the CDS contracts were sold to Hudson. This purported disclosure was incomplete. In addition to lacking third-party verification, no external counterparty had participated in any aspect of the CDS contracts. All of the CDS contracts had been produced, signed, and priced internally by two Goldman trading desks which exercised complete control over the Hudson CDO.

176. Internally, while Hudson was being constructed, Goldman personnel acknowledged that they were using a novel pricing approach. At one point, Swenson sent an email to Birnbaum, raising questions about how they could explain some of the pricing decisions. Swenson wrote that he was: "concerned that the levels we put on the abx cdo for single-a and triple-bs do not compare favorably with the single-a off of a abx 1 + abx 2 trade," telling Birnbaum "[w]e need a goo[d] story as to why we think the risk is different." The prices that Goldman established for the CDS contracts that Hudson "bought" affected the value of the CDO and the Hudson securities Goldman sold to investors, but the Offering Circular failed to disclose the extent to which Goldman had single-handedly controlled the pricing of 100% of the CDOs assets.

177. Goldman also failed to disclose the fact that it would be the sole short party in the entire $2 billion CDO. The Goldman materials told investors that an affiliate, GSI, would be the "credit protection buyer" or initial short party for the Hudson CDO. It was common practice for underwriters to act as the initial short party in a CDO, acting as an intermediary between the CDO vehicle and broker-dealers offering competitive bids in order to short the assets referenced in the CDO. The disclosure provided by Goldman

contained boiler plate language suggesting that would be the role played by GSI in the Hudson transaction. Goldman never disclosed that it had provided all of Hudson's assets internally, GSI was not acting as an intermediary, and GSI would not be passing on any portion of the short interest in Hudson to any other party, but would be keeping 100% of the short position. The Hudson disclosures failed to state that, rather than serving as an intermediary, Goldman was making a proprietary investment in the CDO which placed it in a direct, adverse position to the investors to whom it was selling the Hudson securities.

178. The Offering Circular also contained a section entitled, "Certain Conflicts of Interest," which included a subsection entitled, "The Credit Protection Buyer and Senior Swap Counterparty," in which Goldman could have disclosed its short position. Rather than disclose that short position, however, Goldman stated in part:

> GSI and/or any of its affiliates may invest and/or deal, for their own respective accounts for which they have investment discretion, in securities or in other interests in the Reference Entities, in obligations of the Reference Entities or in the obligors in respect of any Reference Obligations or Collateral Securities (the "Investments"), or in credit default swaps (whether as protection buyer or seller), total return swaps or other instruments enabling credit and/or other risks to be traded that are linked to one or more Investments.

This disclosure indicates that GSI or an affiliate "may invest and/or deal" in securities or other "interests" in the assets underlying the Hudson CDO, and "may invest and/or deal" in securities that are "adverse to" the Hudson "investments." The Offering Circular, however, misrepresented Goldman's investment plans. At the time it was created in December 2006, Goldman had already determined to keep 100% of the short side of the Hudson CDO and act as the sole counterparty to the investors buying Hudson securities, thereby acquiring a $2 billion financial interest that was directly adverse to theirs.

179. Consistent with both industry and Goldman practice, customers learning of GSI's role as the initial sole counterparty in Hudson would have assumed that GSI planned to sell its initial short position to other parties.

180. Goldman placed a priority on selling Hudson securities, delaying the issuance of other CDOs in order to facilitate Goldman's own proprietary short position in Hudson. Goldman sales representatives reported that clients expressed skepticism regarding the quality of the Hudson assets, but Goldman continued to promote the sale of the CDO as if its interests were truly aligned with its clients' interests.

181. Once it constructed the Hudson CDO, Goldman personnel were focused on completing and selling the Hudson securities as quickly as possible. Goldman senior executives closely followed Hudson's development and sale. Hudson was discussed, for example, at five different Firmwide Risk Committee meetings attended by senior Goldman executives and chaired by CFO David Viniar. Mortgage Department executives also sent progress reports to the senior executives on Hudson. On October 25, 2006, for example, Sobel sent an email to COO Gary Cohn and Viniar alerting them to Hudson sales efforts and the pricing of its securities.

182. The Goldman sales force sold most of the Hudson securities prior to the CDOs closing in December 2006, and continued its sales efforts after the closing as well. Overall, Goldman sold Hudson securities to 25 investors. Morgan Stanley made the largest investment, taking $1.2 billion of the super senior portion of the CDO. Other investors included National Australia Bank, which purchased $80 million worth of the AAA rated securities; Security Benefit Mutual, which bought $10 million of the AA rated securities; and Bear Stearns, which bought $5 million of the equity tranche.

183. On October 30, 2006, after Hudson was presented to investors and pre-sold most of its securities, Peter Ostrem, the head of the CDO Origination Desk, sent a celebratory email to the ABS and CDO teams with Hudson highlights. He wrote: "Goldman was the sole buyer of protection on the entire $2.0 billion of assets," meaning Goldman had kept 100% of the short position. By shorting Hudson, Goldman had transferred $1.2 billion worth of risky ABX assets Goldman wanted off its books, and shorted another $800 million in RMBS securities.

184. Over the next year, Goldman pocketed nearly $1.7 billion in gross revenues from Hudson, all at the direct expense of the Hudson investors. Goldman collected $1.393 billion in gains from its short of the assets referencing its ABX inventory and collected another $304 million in gains due to its short of the other $800 million in single name CDS contracts included in Hudson.

185. Goldman also received substantial fees from the roles it played in underwriting and administering Hudson, including $31 million in underwriting fees and $3.1 million for serving as the liquidation agent.

Overall, Goldman recorded a profit from Hudson of more than $1.35 billion.

186. In contrast to Goldman, Hudson investors suffered substantial losses. In March 2007, less than three months after the issuance of the Hudson securities, when asked to analyze how a holder of Hudson securities could hedge against a drop in their value, a Goldman trader wrote: "their likelihood of getting principal back is almost zero." Six months later, the credit rating downgrades began. In September 2007, Moody's downgraded several Hudson securities and followed with additional downgrades in November 2007. S&P began downgrades of Hudson in December 2007, and by February 2008, had downgraded even the AAA rated securities.

187. Morgan Stanley, the largest Hudson investor, lost $930 million. As other investors incurred increasing losses, they sold their securities back to Goldman at rock bottom prices. In September 2007, for example, nine months after the Hudson securities were first issued, Goldman repurchased $10 million worth of Hudson securities from Greywolf Capital at a price of five cents on the dollar; in October 2007, another hedge fund sold $1 million in Hudson securities back to Goldman at a price of 2.5 cents on the dollar. In November 2008, Hudson was completely liquidated by Goldman. Today, Hudson securities are worthless.

188. In sum, Goldman constructed Hudson as a way to transfer its ABX risk to the investors who bought Hudson securities. When marketing the Hudson securities, Goldman misled investors by claiming its investment interests were aligned with theirs, when it was the sole short party and was betting against the very securities it was recommending. Goldman also

implied that Hudson's assets had been purchased from outside sources, and failed to state that it had selected the majority of the assets from its own inventory and priced the assets without any third party participation. ***By holding 100% of the short position at the same time it solicited clients to buy the Hudson securities, Goldman created a conflict of interest with its clients, concealed the conflict from them, and profited at their expense***.

2. Anderson

189. In the summer of 2006, Goldman began work on Anderson, a $500 million synthetic CDO whose assets were single name CDS contracts referencing subprime RMBS securities with mezzanine credit ratings. To execute the Anderson CDO, Goldman partnered with GSC, a New York hedge fund founded by a former Goldman partner. Goldman personnel working on the CDO included Peter Ostrem, head of the CDO Origination Desk, and Matthew Bieber, a CDO Origination Desk employee assigned to be deal captain for the Anderson CDO.

190. GSC and Goldman participated together in the selection of assets for Anderson. Anderson was designed to be a synthetic CDO whose assets would consist solely of CDS contracts referencing RMBS securities whose average credit ratings would be BBB or BBB-.

191. Anderson's assets were purchased from 11 different broker-dealers from September 2006 to March 2007. Goldman was the source of 28 of the 61 CDS contracts in Anderson, and Goldman retained the short side. Goldman also served as the sole credit protection buyer to the Anderson CDO, acting as the

intermediary between the CDO and the various broker-dealers selling it assets.

192. By February 2007, the Anderson warehouse account contained $305 million out of the intended $500 million worth of single name CDS, many of which referenced mortgage pools originated by New Century, Fremont, and Countrywide-subprime lenders known within the industry for issuing poor quality loans and RMBS securities. Approximately 45% of the referenced RMBS securities contained New Century mortgages.

193. During the same time period in which the Anderson single name CDS contracts were being accumulated, Goldman was becoming increasingly concerned about the subprime mortgage market, was reacting to bad news from the subprime lenders it did business with, and was building a large short position against the same types of BBB rated RMBS securities referenced in Anderson. By February 2007, the value of subprime RMBS securities was falling, and the Goldman CDO Origination Desk was forced to mark down the value of the long single name CDS contracts in its CDO warehouse accounts, including Anderson.

194. In February 2007, Goldman CEO Lloyd Blankfein personally reviewed the Mortgage Department's efforts to reduce its subprime RMBS whole loan, securities, and residual equity positions, asking Montag: "[W]hat is the short summary of our risk and the further writedowns that are likely[?]" After a short report from Montag, Blankfein replied:

> [Y]ou refer to losses stemming from residual positions in old deals. Could/should we have cleaned up these books before and are we

> doing enough right now to sell off cats and dogs in other books throughout the division?

195. Sparks also made increasingly dire predictions about the decline in the subprime mortgage market and issued emphatic instructions to his staff about the need to get rid of subprime loans and other assets. On February 8, 2007, for example, Sparks wrote:

> Subprime environment – bad and getting worse. Everyday is a major fight for some aspect of the business (think whack-a-mole) . . . . [P]ain is broad (including investors in certain GS issued deals).

196. On February 14, 2007, Sparks exchanged emails with Goldman's Co-President Jon Winkelried about the deterioration in the subprime market:

> Mr. Winkelried: Another downdraft?
>
> Mr. Sparks: Very large – it's getting messy . . . . Bad news everywhere. Novastar bad earnings and 1/3 of market cap gone immediately. Wells [Fargo] laying off 300 subprime staff and home price appreciation data showed for first time lower prices on homes over year broad based.

197. On February 26, 2007, when Montag asked him about two CDO^2 transactions being assembled by the CDO Origination Desk, Timberwolf and Point Pleasant, Sparks expressed his concern about both:

> Mr. Montag: cdo squared–how big and how dangerous
>
> Mr. Sparks: Roughly 2bb, and they are the deals to worry about

198. Goldman was also aware that its longtime customer, New Century, was in financial distress. On February 7, 2007, New Century announced publicly it would be restating its 2006 earnings, causing a sharp drop in the company's share price. On February 8, 2007, Goldman's Chief Credit Officer Craig Broderick sent Sparks and others a press clipping about New Century and warned:

> [T]his is a materially adverse development. The issues involve inadequate [early payment default] provisions and marks on residuals. . . . [I]n a confidence sensitive industry it will be ugly even if all problems have been identified. . . . We have a call with the company in a few minutes (to be led by Dan Sparks).

199. On some occasions, Sparks addressed negative news about New Century in the same email he discussed liquidating assets in warehouse accounts for upcoming CDOs. On March 8, 2007, for example, Sparks noted in an email to senior executives: "New Century remains a problem" due to loans experiencing early payment defaults, and informed them that the Mortgage Department had "liquidated a few deals and could liquidate a couple more."

200. On February 23, 2007, Sparks sent an email to senior Goldman executives estimating that Goldman had lost $72 million on the holdings in its CDO warehouse accounts, due to falling prices. He directed Mortgage Department personnel to liquidate rather than securitize the assets in certain warehouse accounts. Two days later, on February 25, 2007, Sparks informed senior executives of his intention to liquidate Anderson:

> [T]he CDO business liquidated 3 warehouses for deals of $530mm (about half risk was subprime related). . . . One more CDO warehouse may be liquidated this week – approximately $300mm with GSC as manager.

201. After Sparks relayed this decision, Ostrem and Bieber began to strategize ways to convince Sparks to reverse his decision. Ostrem and Bieber assembled a list of likely buyers of the Anderson securities to present to Sparks, and brainstormed about other CDOs that could potentially buy Anderson securities for their asset pools. Ostrem also proposed allowing a hedge fund to short assets into the deal as an incentive to buy the Anderson securities, but Bieber thought Sparks would want to "preserve that ability for Goldman."

202. At some point, Sparks changed his mind and decided to go forward with underwriting the Anderson CDO. The Anderson CDO closed on March 20, 2007. As finally constructed, 100% of its assets were CDS contracts referencing $307 million in mezzanine subprime RMBS securities, meaning RMBS securities carrying BBB or BBB- credit ratings. About 45% of the subprime mortgages in the referenced RMBS securities were issued by New Century. Another 8% were issued by Countrywide, and almost 7% were issued by Fremont. Goldman took about 40% of the short side of the Anderson CDO.

203. During March 2007, selling Anderson securities became a top priority for Goldman. Goldman even put another deal on hold, the Abacus 2007-AC 1 deal with the Paulson hedge fund, to promote Anderson. As Egol advised Goldman personnel: "Given risk priorities, subprime news and market conditions,

we need to discuss side-lining [Abacus 2007-AC1] in favor of prioritizing Anderson in the short term."

204. On March 13, 2007, Goldman issued internal talking points for its sales force on the Anderson CDO. Among the points highlighted were:

> Portfolio selected by GSC. Goldman is underwriting the equity and expects to hold up to 50%. . . . Low fee structure[.] . . . No reinvestment risk.

The talking points described Goldman as holding up to 50% of the equity tranche in the CDO – worth about $21 million, without mentioning that Goldman would also be holding 40% – about $135 million – of the short side of Anderson, placing its investment interests in direct opposition to the investors to whom it was selling Anderson securities. Goldman also did not disclose to potential investors that it had almost canceled the CDO, due to its assets' falling values.

205. Of particular concern for investors was the concentration of New Century mortgages in Anderson. On March 13, 2007, a potential investor, Rabobank, asked Goldman sales representatives: "how did you get comfortable with all the new centu ry [sic] collateral in particular the new century serviced deals – con sidering [sic] you are holding the equity and their servicing may not be around is that concerning for you at all?" Goldman and GSC prepared a list of talking points with which to respond to the investor:

- Historically New Century has on average displayed much better performance in terms of delinq[uency] and default data
- Prepayments have tended to be higher lowering the extension risk

- Losses and REO [Real Estate Owned by a lender taking possession of a property] are historically lower than the rest of the market
- Traditionally the structures have strong enhancement/subordination.

206. The talking points did not disclose that, in fact, Goldman, too, was uncomfortable with New Century mortgages. On March 8, 2007, five days before receiving the investor's inquiry, Sparks had reported to senior Goldman executives, including Co-President Gary Cohn and CFO David Viniar, that New Century mortgages "remain[ed] a problem on [early payment default]." On March 13, the same day as the investor inquiry, Goldman personnel completed a review of New Century mortgages with early payment defaults that were on Goldman's books and found fraud, "material compliance issues," and collateral problems. The review found that "62% of the pool has not made any pmts [payments]" and recommended "putting back 26% of the pool" to New Century for repurchase "if possible." Goldman also did not disclose to the investor that it was shorting 40% of the Anderson CDO.

207. Some Goldman clients also had questions about GSC's involvement in Anderson. An Australian sales representative wanted "more color on asset selection process, especially with respect to GSC involvement." This clarification was necessary, because although GSC's role was mentioned in numerous internal Goldman documents, the official Anderson marketing materials did not mention GSC's role in asset selection. In previous drafts of the marketing materials, for example, Goldman stated that "Goldman Sachs and GSC Group ("GSC") co-selected the assets"; "GSC pre-screens and evaluates

assets for portfolio suitability"; the CDO was "co-sponsored by Goldman Sachs and GSC Eliot Bridge Fund"; and "Goldman Sachs and GSC ha[ve] aligned incentives with Anderson Funding by investing in a portion of equity." But all of the references to GSC were removed from the final documents.

208. Despite the poor reception by investors, Goldman continued "pushing the axe" with its sales force to sell Anderson securities. Bieber identified and monitored potential investors and attempted to sell Anderson securities to pension funds and place Anderson securities in other Goldman CDOs as collateral securities. On March 20, 2007, when Bieber reported selling $20 million in Anderson securities, his supervisor, Ostrem, responded with the single word: "Profit!" In a separate email a week later, Ostrem told Bieber he did an "[e]xcellent job pushing to closure these deals in a period of extreme difficulty."

209. After several months of effort, Goldman sold approximately $102 million of the $307 million in Anderson securities.

210. Goldman profited from holding 40% of the short position on certain Anderson assets, which produced a $131 million gain at the direct expense of the investors to whom Goldman had sold the Anderson securities. Goldman was also paid $200,000 for serving as the liquidation agent, and collected $2 million in CDS premiums while it warehoused Anderson assets.

211. Anderson's investors suffered substantial losses. Seven months after its issuance, in November 2007, Anderson securities experienced their first ratings downgrades. At that point, 27% of the assets underlying Anderson were downgraded below a B-

rating. Within a year, Anderson securities that were originally rated AAA had been downgraded to BB. In the end, the Anderson investors were wiped out and lost virtually their entire investments.

212. In sum, Goldman constructed the Anderson CDO using CDS contracts referencing subprime RMBS securities, the majority of which were issued by subprime lenders like New Century who were known for issuing poor quality loans. When potential investors asked how Goldman was able to "get comfortable" with the New Century mortgage pools referenced in Anderson, Goldman attempted to dispel concerns about the New Century loans, withheld information about its own discomfort with New Century, and withheld that it was taking 40% of the short side of the CDO, essentially betting against the very securities it was selling to its clients. Instead, Goldman instructed its sales force to tell potential investors that Goldman was buying up to 50% of the equity tranche. Goldman also did not disclose to potential investors that it had almost cancelled the CDO due to the falling value of its assets.

3. Timberwolf I

213. Timberwolf I was a \$1 billion hybrid CDO^2 transaction that Goldman constructed, underwrote, and sold.[9] It contained or referenced A rated CDO securities which, in turn, referenced primarily BBB rated RMBS securities. The assets in Timberwolf were selected by Greywolf Capital Management (a registered investment adviser founded by former Goldman employees), with the approval of Goldman.

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[9] A collateralized debt obligation squared (CDO^2) is backed by a pool of CDO tranches.

Greywolf served as the collateral manager of the CDO. Goldman effectively served as the collateral put provider. Timberwolf was initiated in the summer of 2006, and closed in March 2007.

214. Timberwolf's single name CDS and CDO securities were acquired from 12 different broker-dealers. Goldman was the single largest source of assets, providing 36% of the assets by value, including $15 million in single name CDS contracts naming Abacus securities. As a result, Goldman held 36% of the short interest in Timberwolf.

215. Altogether, Timberwolf contained 56 different assets, of which 51 were single name CDS contracts referencing CDO securities and five were cash CDO securities. The 51 single name CDS contracts referenced both CDO and CDO^2 securities, and each CDO or CDO^2 security contained or referenced its own RMBS, CMBS, or CDO securities or other assets. In total, Timberwolf had over 4,500 unique underlying securities and a grand total of almost 7,000 securities. This process was further complicated by the fact that the CDO assets in Timberwolf were privately issued and often had little or no publicly available information on the underlying assets they contained.

216. Goldman's marketing booklet for Timberwolf stated that Goldman was purchasing 50% of the equity tranche, and that Greywolf was purchasing the other 50%. However, the booklet failed to disclose that Goldman's equity investment was far outweighed by its short investment.

217. By the time Greywolf and Goldman were nearing completion of the acquisition of the Timberwolf assets in the spring of 2007, Goldman was becoming increasingly concerned about the

deteriorating subprime mortgage market and the falling value of the assets in its CDO warehouse accounts. In February 2007, Sparks, the Mortgage Department head, and Goldman senior executive Thomas Montag exchanged emails about the warehouse risk posed by Timberwolf and another pending CDO^2 called Point Pleasant. Montag asked Sparks: "cdo squared–how big and how dangerous"" Sparks responded: "[R]oughly 2 bb [billion], and they are the deals to worry about." Sparks also told Montag that, due to falling subprime prices, the assets accumulated in the warehouse account for the $1 billion Timberwolf CDO had already incurred significant losses, those losses had eaten through all of Greywolf's portion of the warehouse risk sharing agreement, and any additional drops in value would be Goldman's exclusive obligation.

218. In March 2007, due to the falling values of subprime RMBS and CDO securities, Goldman decided against completing several CDOs under construction, and liquidated the assets in their warehouse accounts. Goldman decided, in contrast, to accelerate completion of Timberwolf.

219. At the same time, on March 3, 2007, Sparks memorialized the following remarks after a telephone call: "Things we need to do . . . Get out of everything." On March 7, 2007, Sparks again reported to Goldman's Firmwide Risk Committee on accelerating problems in the subprime mortgage market:

- "Game Over" – accelerating meltdown for subprime lenders such as Fremont and New Century.

- The Street is highly vulnerable, ... Current strategies are to "put back" inventory, . . . or liquidate positions.
- The Mortgage business is currently closing down every subprime exposure possible.

220. On March 8, 2007, Sparks emailed several senior executives, including Viniar and Cohn about "Mortgage risk": "we are trying to close everything down, but stay on the short side."

221. On March 8, 2007, in an email to senior management, Sparks listed a number of "large risks I worry about." At the top of the list was "CDO and Residential loan securitization stoppage – either via buyer strike or dramatic rating agency change." Sparks was referring to the possibility that Goldman would be unable to securitize and sell its remaining subprime mortgage related inventory by repackaging it into RMBS and CDOs for sale to customers.

222. Despite Goldman's internal concerns of the CDO market, the Company proceeded with Timberwolf I and the offering closed on March 27, 2007, approximately six weeks ahead of schedule. The final CDO had $1 billion in cash and synthetic assets, including $960 million in single name CDS referencing CDO securities, and $56 million in cash CDO securities.

223. Not surprisingly, selling Timberwolf securities was a high priority for Goldman. Sparks worked with senior sales managers to review ideas, telling them: "I can't overstate the importance to the business of selling these positions and new issues."

224. On March 9, 2007, Sparks emailed a call for "help" to Goldman's top sales managers around the world to "sell our new issues – CDOs and RMBS – and to sell our other cash trading positions." The Goldman sales manager for Europe and the Middle East suggested that Sparks focus the CDO sales efforts abroad, because the clients there were not involved in the U.S. housing market and therefore were "not feeling pain."

225. During the spring and summer of 2007, the Goldman Syndicate emailed the CDO sales force a list of "Senior CDO Axes" or sales directives on a weekly and sometimes daily basis, many of which placed a priority on selling Timberwolf securities. As early as February, the Goldman sales force developed "broader lists" of clients to target for Timberwolf sales. After exhausting those initial lists, Goldman sales personnel began to target "non-traditional" buyers' as well as clients outside of the United States. The sales force had some early successes. On March 28, 2007, for example, the Syndicate included a note in one of the axe sheets:

> Great job Cactus Raazi trading us out of our entire Timberwolf Single-A position – $16mm. Sales – Good job over the last two weeks moving over $66mm of risk off the axe sheet. Please stay focused on trading these axes.

226. As sales began to flag in April, Sparks sent emails reminding Goldman sales personnel that Timberwolf "is our priority." On one occasion, on April 19, 2007, Sparks suggested to a sales manager offering "ginormous credits" as an incentive to sell Goldman's CDO securities: "for example, let's double the current offering of credits for [T]imberwolf." Sparks was

informed in response: "[W]e have done that with timberwolf already."

227. On March 9, 2007, Harvey Schwartz, a senior executive at Goldman Sachs, expressed concern to Sparks and others about what Goldman sales personnel were telling clients: "Seems to me . . . one of our biggest issues is how we communicate our views of the market – consistently with what the desk wants to execute." Sparks responded by outlining several concerns and the need for the sales team and traders to work together. He wrote:

> 3 things to keep in mind:
>
> (1) The market is so volatile and dislocated that priorities and relative value situations change dramatically and constantly.
>
> (2) Liquidity is so light that discretion with information is very important to allow execution and avoid getting run over.
>
> (3) The team is working incredibly hard and is stretched.

He concluded: Priority 1 – sell our new issues and our cash positions.

228. Despite the urgency communicated by Goldman management, Timberwolf sales slowed. By May 11, 2007, only one Timberwolf sale had taken place in the previous several weeks. Goldman personnel also knew that the value of the Timberwolf securities, and the value of their underlying assets, were falling.

229. On May 11, 2007, Sparks notified Goldman senior executives that marking down the value of the

unsold CDO securities would indicate to the firm that their current market value had become a "real issue":

> Cdo positions and market liquidity and transparency have seized. I posted senior guys that I felt there is a real issue. . . . We are going to have a very large mark down – multiple hundreds. Not good.

That same evening, David Lehman sent out a "Gameplan" to colleagues in the Mortgage Department announcing that Goldman was going to undertake a detailed valuation of its CDO^2 securities using three different valuation methods, and would also take "a more detailed look" at the values of the assets in the CDO warehouse accounts and in Goldman's own inventory. Using the three valuation methods, the presentation estimated that the loss in value and the total writedowns required for the firm's CDO assets were between $237 and $448 million.

230. Also on May 11, Chief Credit Officer Craig Broderick sent an email to his team to set up a survey of Goldman clients who might encounter financial difficulty if Goldman lowered the value of the CDO securities they had purchased. As explained earlier, some Goldman clients had purchased their CDO securities with financing supplied by Goldman that required them to post more cash margin if the financed securities lost value. Other clients had invested in the CDO securities by taking the long side of a CDS contract with Goldman and also had to post more cash collateral if the value of the CDO securities declined. All of these clients would also have to record a loss on their books due to the lowered valuations.

231. With respect to the CDO securities that had yet to be sold, Goldman senior executive Harvey

Schwartz raised another issue related to lowering the values of the CDO securities Goldman was selling to clients: "[D]on't think we can trade this with our clients andf [sic] then mark them down dramatically the next day. . . . Needs to be a discussion if that risk exists." In an email to Sparks, Montag, and Schwartz, Goldman senior executive Donald Mullen acknowledged concerns "about the representations we may be making to clients as well as how we will price assets once we sell them to clients." The executives also agreed, however, not to "slow or delay" efforts to sell Timberwolf securities if they got "strong bids."

232. The CDO valuation project generated many comments on how to price the firm's unsold CDO securities, including Timberwolf. One Goldman employee, who was applying Goldman's most common valuation method to Timberwolf, wrote that the price should be dramatically lower:

> Based on current single-A CDO marks, the A2 tranche of Timberwolf would have a price of 72 cents on the dollar.

He also noted:

> Based on a small sample of single-A CDOs for which we have complete underlier marks, we believe that the risks of the RMBS underliers are frequently not fully reflected in the marks on the CDOs. If the trends in this small sample are extrapolated, the fair spread on the CDOs could even be double where they are marked now; if that were the case, the price of the A2 tranche of Timberwolf would actually be 35-41 cents on the dollar, depending on the correlation.

Several days later, in preparation for a meeting with senior executives on the valuation issue, the same Goldman employee calculated that, for the A2 tranche of Timberwolf, the "price based on CDO marks" was 66 cents on the dollar, while the "price based on RMBS marks" was 24 cents on the dollar.

233. Throughout the valuation process, senior management, including Co-President Gary Cohn, was kept posted on how the Mortgage Department planned to value the firm's CDO assets. On Sunday, May 20, 2007, the Mortgage Department presented its findings in a 9:00 p.m. conference call with CFO David Viniar and others. The presentation's executive summary expressed concern about valuing a range of CDO assets, including unsold securities from Goldman-originated CDOs. The presentation stated: "[T]he desk is most concerned about the CDO^2 positions, comprised of the recent Timberwolf and Point Pleasant transactions. The lack of liquidity in this space and the complexity of the product make these extremely difficult to value."

234. The presentation recommended unwinding and selling the assets in the CDO warehouse accounts and using "independent teams" to continue to value the unsold CDO securities from Goldman originations. It also recommended switching to a targeted sales effort for the unsold CDO^2 securities, focused on four hedge fund clients: Basis Capital, Fortress, Polygon, and Winchester Capital. The Goldman sales force apparently felt those four hedge funds were the clients most likely to buy the CDO^2 securities, and two of them, Basis Capital and Polygon, did subsequently purchase Timberwolf securities. An appendix to the presentation identified another 35 clients for targeted sales efforts and provided an assessment of the CDO

sales efforts for each. Several of those clients later purchased Timberwolf securities.

235. The CDO valuation project undertaken in May provided clear notice to Goldman senior management at the highest levels that its CDO assets had fallen sharply in value, and that despite their lower value, the Mortgage Department planned to aggressively market them to customers.

236. Despite Goldman's internal analysis that the value of the Timberwolf securities was in rapid decline, the Company did not lower the prices at which it marketed the securities to clients. Instead, Goldman took substantial writedowns on the value of its own CDO inventory on May 25, 2007. For example, Goldman marked down the AAA rated Timberwolf A2 securities to a value of $80. At the same time, Goldman continued to market them at inflated prices, selling Timberwolf A2 securities to clients at $87.00 on May 24, at $83.90 on May 30, and at $84.50 on June 11. On May 25, Goldman also marked the AA rated Timberwolf B securities to an internal value of $65.00. Over a month later, Goldman sold $9 million of those AA rated securities to Bank Hapoalim at a price of $78.25, but by then Goldman's internal valuation had fallen to $55, a difference of more than 30% of the market value.

Timberwolf Sales to Basis Capital

237. A couple of weeks before the CDO valuation project, Goldman's Australia sales representative, George Maltezos, announced he had found a potential Australian buyer for a Goldman CDO being constructed by the Correlation Desk: "I think I found white elephant, flying pig and unicorn all at once."

This "white elephant, flying pig and unicorn" would later be identified at Basis Capital.

238. Maltezos began pressing Basis Capital to buy the securities. On May 22, Maltezos urged Basis Capital to consider buying the securities before the end of the quarter:

> I appreciate you are flat chat [busy] at the moment, but pls [please] keep in mind GS is an aggressive seller of risk for QTR [quarter] end purposes (last day of quarter is this Friday). We would certainly appreciate your support, and equally help create something where the return on invested capital for Basis is over 60%.

At the same time Maltezos was claiming that a Timberwolf investment could provide over a 60% return on invested capital, Goldman's internal marks were showing that Timberwolf was continuing to fall in value.

239. Basis Capital indicated that it was interested in the Timberwolf securities, but had several issues it needed to work through. First, Basis Capital indicated that Goldman would have to help it find financing for the purchase price. Second, Basis Capital was concerned about the value of its existing CDO^2 investment with Goldman. On April 19, 2007, Basis Capital had purchased BBB rated Point Pleasant securities at a price of $81.72. Goldman had provided the financing for this purchase. Two weeks later, Goldman had marked down the value of the securities to $76.72, and asked Basis Capital to post additional cash collateral totaling $700,000. When Basis Capital asked how the value of the security had fallen $5 in just two weeks, Goldman responded that the price had

gone back up to $81.72, and no additional cash was required.

240. In May and June 2007, Maltezos worked to convince Basis Capital to purchase $100 million in Timberwolf securities. At one point Basis Capital pressed for a lower sales price, but was told by Maltezos: "I don't think the trading desk shares the sentiment with regard to such spread levels [lower prices]." During the negotiations over the Timberwolf sale, on June 12, 2007, Goldman again marked down the value of the Point Pleasant securities to $75, and again asked Basis to post more cash collateral. When Basis Capital asked Maltezos to justify the lower value, Maltezos wrote:

> [T]here has certainly been further softening in the market since the Point Pleasant trade was put on 8 weeks ago. We have infact [sic] traded some Point Pleasant BBBs at this level in the last 2 weeks.

In fact, no such sales had taken place, and the lower value could not be justified by any sales transactions. The lower mark was instead related to Goldman's CDO valuation project in May, which had concluded that its CDO^2 securities had lost significant value.

241. Stuart Fowler at Basis Capital brought up the valuation issue in the context of the Timberwolf securities, and asked Maltezos: "I need to be very clear on this and are we going to see a similar problem on [T]imberwolf?" Maltezos responded: "Stuart – I assure you no foul here," and offered to set up some "1-on-1 time with the trading desk" to discuss pricing.

242. On June 13, 2007, Lehman reported that Goldman had reached agreement on $100 million in Timberwolf sales to Basis Capital. The sale consisted

of the hedge fund taking the long side of a CDS contract with Goldman, referencing $50 million in AAA rated Timberwolf securities and $50 million in AA rated Timberwolf securities. Lehman told Montag that the CDS premiums that Basis Capital had agreed to accept implied a cash price of $84 for the AAA securities and $76 for the AA securities. Montag asked what Goldman's internal mark was for the Timberwolf AA securities, and Lehman responded: "$65."

243. The Timberwolf sale to Basis Capital was finalized on June 18, 2007. Goldman provided the financing. Just two weeks later, Goldman informed Basis Capital that the Timberwolf securities had lost value and required the hedge fund to post additional cash collateral.

244. Eight days later, on July 12, Goldman again marked down the value of the Timberwolf securities to prices of $65 and $60, after having sold them to Basis Capital one month earlier at $84 and $76. This repricing resulted in a $37.5 million movement in the value of the securities, and required Basis Capital to post substantially more cash collateral with the firm. On July 13, 2007, Basis Capital told Goldman that one of its funds was "in real trouble." On July 16, Goldman again marked down Basis Capital's securities to prices of $55 for AAA and $45 for AA. These prices matched Goldman's internal valuations. By the end of July, Basis Capital was forced to liquidate its hedge fund.

Other Timberwolf Sales

245. At the conclusion of the CDO valuation project, which found that Timberwolf and Goldman's other CDO securities had lost significant value, the Mortgage Department resumed its efforts to push Timberwolf sales. On May 24, 2007, a Goldman sales

associate told Lehman and Sparks that he wanted more information to send to a European hedge fund that was "not experts in this space at all but [I] made them a lot of money in correlation dislocation and will do as I suggest. Would like to show stuff in today if possible." Lehman told the sales associate that he was available to get on the telephone with the clients, and forwarded him the Timberwolf offering circular and marketing materials.

246. On June 5, 2007, Goldman trader Benjamin Case emailed Lehman with a "[g]ameplan for distribution" or sales of Goldman's remaining CDO^2 securities. The plan was to target "institutional buyers that can take larger bite size than traditional CDO buyers . . . for example, Asian banks and insurance companies." Case also noted that Goldman was shorting "51 CDO names in the two portfolios [Timberwolf and Point Pleasant] and we have been aggressively sourcing further protection in the CDS market on names in the two portfolios recently."

247. In early June, Goldman targeted a Korean insurance company called Hungkuk Life for Timberwolf sales. According to a Goldman employee in the Japan sales office, Jay Lee, "the largest hurdle from the client's perspective is whether or not they can get the mandate to buy something backed by synthetically sourced CDO's [sic], as they have never bought CDO^2 before." Lee was also concerned that the value of the securities would drop soon after the office sold the Timberwolf securities to the insurance company. Lee stated:

> [T]he largest hurdle from a sales' perspective is MTM [mark to market]. It is an important client, and if the mark widens out more than 1pt immediately after selling the

> asset to them, sales cannot sell it. Understanding that it is a volatile asset, sales wants to know that where we sell it to the client will not be more than 1pt less than where the mark would be, provided no new market information.

Despite Lee's concerns, on June 1, he reported that Hungkuk Life had purchased $36 million in AAA rated Timberwolf securities. Sparks responded "good job – keep going."

248. Six days later, on June 7, 2007, the head of the Goldman Japan sales office, Omar Chaudhary, contacted Sparks and Lehman about a possible additional sale of Timberwolf securities to Hungkuk Life. Chaudhary wrote that the head of Goldman's Korean sales office was "pushing on our personal relationships" to make the sale and wanted to be assured he'd be paid more if he "got it done":

> Jay and I spoke to the head of Korea Sales today. He said that he feels like he can push for H[ungkuk] Life to increase their size from the 36mm of AAA's and wanted to see if we would pay more GC's [sales credits] if he got it done. Told him that if we sell –45-50mm+ [$45-50 million more] that we would honor the 7.0% even if we trade at 84.5 dollar px [expected price]. Trust you will support this as we are pushing on our personal relationships to get this done.

Lehman and Sparks told Chaudhary to "go for it" and "[g]et `er done." The Korean office did get it done, and Goldman sold another $56 million in Timberwolf securities to Hungkuk Life at a price of $84.50. The sales representative was awarded the 7% sales credit.

Sparks wrote to the sales office: "you boys are awesome and many people are noticing." Montag, a senior Goldman executive monitoring the Timberwolf sales, told the mortgage team it had done an "incredible job – just incredible."

249. On June 11, 2007, Lehman received an email from the Goldman Syndicate asking whether the CDO axe sheet, which included directives to sell Timberwolf securities, could be sent to the Japan sales office for re-distribution to sales representatives across Asia. Lehman agreed: "let's send to all Japan sales." Two days later, on June 13, 2007, the Japan sales office reported over $250 million in new sales of Goldman's CDO securities, including Timberwolf.

250. Montag continued to monitor the sales of Timberwolf as well as other CDO securities in Goldman's inventory and warehouse accounts. On June 22, 2007, Sparks reported to him on the completion of a number of sales of CDO and RMBS securities that Goldman had purchased from the two failed Bear Stearns hedge funds. Montag asked Sparks to provide him with a "complete rundown" on "what[']s left." Sparks responded that the "main thing left" was $300 million in Timberwolf securities. Montag responded: "***boy that timeberwo[l]f was one shitty deal***."

251. Despite Montag's assessment of Timberwolf, he continued to press for the sale of Timberwolf securities to Goldman clients. On June 25, 2007, Sparks emailed Montag and others with another update on selling Goldman's remaining CDO assets. Sparks informed the group that Goldman would probably have to lower the values of the CDO assets over the next few days, but that the net effect for Goldman would be positive, since its short position

was larger than its long. In fact, the Mortgage Department made $42.5 million that day. Montag remained focused on Timberwolf, responding: "[h]ow are twolf sales doing?"

252. On July 12, 2007, another Goldman sales representative, Leor Ceder, reported selling $9 million in Timberwolf securities to Bank Hapoalim at a price of $78.25. Goldman trader Mitchell Resnick asked Lehman "to pay him well on this." Ceder was paid an 8% sales credit. That was Goldman's last Timberwolf sale, even though its Syndicate continued to list the CDO as a top sales priority for months afterward.

253. Goldman ultimately sold about $853 million of the $1 billion in Timberwolf securities to about 12 investors.

Limited Disclosures

254. Despite their aggressive sales efforts, Goldman sales personnel typically did not help potential investors analyze the Timberwolf securities and the 4,500 unique assets underlying the CDO. One Goldman employee told his colleagues: "In terms of telling customers. I prefer to give them the general idea of the trade. Then give them the excel spread sheet with our info on ref obs [reference obligations] and let them draw their own conclusions." Another Goldman employee, discussing a potential buyer of Timberwolf, warned:

> [H]e is going to want to look at the TWOLF trade on a fundamental basis with a lot of supporting runs to back up any additional mark downs we have – telling him we are busy when it comes to month end and we can't run that analysis because we are resource-constrained will not be good enough.

Still another Goldman employee stated with respect to Timberwolf and Point Pleasant: "The trickiest part about sharing this [pricing] analysis with custies [customers] is that it shows just how rudimentary our own understanding of these positions actually is."

255. Goldman also in many instances refused to provide investors with its pricing methodology or specific prices or values for the CDO securities it was selling. After its securities began to lose value, Basis Capital emailed George Maltezos, David Lehman, and others asking: "How many times do we have to request data points and scenarios by email. These were read out to us on the call and it was agreed that GS would send them through. I am getting weary of continually hearing about transparency and yet an obvious avoidance of 'putting things to paper.'"

256. Similarly, when Hungkuk Life requested additional information about the underlying Timberwolf assets, Goldman sent an asset report, but only after removing all of its pricing and valuing information related to those assets. In August 2007, Jay Lee from Goldman's Japan sales office told a sales associate who was seeking information about Goldman's marks for Tokyo Star Bank:

> [U]nder no circumstances are we going to be able to provide materials specific to Timberwolf . . . or even use the word "mark" in written materials. . . . Everything will be described in general terms, and if what we provide is too vague or general, the medium for further clarification must be oral, not written.

Lehman added: "[W]e should be clear that the information we are providing is not our pricing methodology but rather some tho[ugh]ts on the current market."

257. A Goldman salesperson in Taiwan sought help in explaining Goldman's markdowns to a bank whose CDO investment had been marked down from about 97 to about 45 cents on the dollar in a matter of weeks:

> [B]ank just bought the altius deal from gs [Goldman Sachs] 5 weeks ago and the mtm [mark-to-market] dropped over 50%. We understand the liquidity is thin but I really need some info to support this price. . . . This is very important as this transaction has a lot to do with our reputation in Taiwan market. I understand that all deals are down and spread is trading wider now. Unless the principal is at risk now, the mtm is not supposed to drop so quickly during such short period of time.

258. Furthermore, as Goldman marked down the values in the summer of 2007, it began to decrease the volume of the securities it was willing to buy or sell at the prices it quoted to clients. Goldman was initially willing to buy or sell CDO securities in blocks of $10 million, but by July, it lowered the maximum size to $3 million for some securities and $1 million for others: "Given the current market environment, we would like our bid for size for CDO valuations to be MAX $3mm for AAA to AA, and $1mm for A and below. No valuations should go out with a bid for $10mm."

"A Day that Will Live in Infamy"

259. The Timberwolf securities issued by Goldman steadily lost money from the day they were issued. Less than four months after they were issued, on July 16, 2007, Lehman instructed the Timberwolf deal

captain, Bieber, to "create an 'unwind' spreadsheet . . . where we can input CDS spds [spreads]/prices and liability prices so we can determine if unwinding these deals makes sense." The analysis appeared to show that it would cost Goldman $140 million to unwind Timberwolf, and the conclusion was to "Hold Off." Instead of unwinding, Goldman continued its sales push.

260. In September 2007, Montag asked for data tracking the drop in prices for a Goldman CDO that experienced a dramatic fall in value, such as Timberwolf. In response, a Goldman employee provided prices for the A2 tranche of the Timberwolf securities using a combination of Goldman's internal marks and the bids provided to investors, from the issuance of the CDO on March 27, 2007 through September. The data showed that, in six months, prices for Timberwolf's AAA rated A2 security had fallen from $94 per security to $15, a drop of almost 80%:

3/31/07	94-12
4/30/07	87-25
5/31/07	83-16
6/29/07	75-00
7/31/07	30-00
8/31/07	15-00
Current	15-00

261. After receiving this pricing history, Bieber, the Timberwolf deal captain, described March 27, the Timberwolf issuance date, as "a day that will live in infamy."

262. Between mid-June 2007 and early August 2007, the value of Timberwolf securities dropped precipitously. Indeed, Goldman personnel were aware

of its falling value while selling the securities to clients. Goldman profited in part from Timberwolf's decline in value due to its 36% short interest in the CDO. In addition, June was the month that Goldman built its $13.9 billion big short, which meant that the decline in most mortgage related assets translated into increasing profits for Goldman.

263. Timberwolf experienced its first credit rating downgrades in November 2007, just eight months after the CDO closed and issued its securities. The downgrades included the AAA rated securities. In March 2008, one year after Timberwolf was issued, its AAA securities were downgraded to junk status. In June 2008, a controlling class of debt investors voted to liquidate Timberwolf, and the deal was terminated in October 2008.

264. Goldman's 36% short position in Timberwolf produced about $330 million in revenues at the direct expense of the clients to whom Goldman had sold the Timberwolf securities. Goldman also made $3 million in interest while the Timberwolf assets were in Goldman's warehouse account.

265. Timberwolf's investors lost virtually their entire investments. Basis Capital ended up declaring bankruptcy and has filed suit against Goldman.

266. One Goldman salesperson expressed remorse over the impact on their customers of CDO sales followed by large markdowns within days or weeks of the client's purchase:

> Real bad feeling across European sales about some of the trades we did with clients. ***The damage this has done to our franchise is very significant.*** Aggregate loss for our clients on just . . . 5 trades alone is 1bln+.

267. In sum, Goldman constructed Timberwolf using CDO assets that began to fall in value almost as soon as the Timberwolf securities were issued, yet solicited clients to buy the securities. Timberwolf contained or referenced CDO assets with more than 4,500 unique mortgage related securities, but Goldman offered potential investors little help in understanding those securities, and targeted clients with limited or no experience in CDO investments. When marketing Timberwolf, Goldman withheld its internal marks showing the securities losing value and did not mention its short position. Senior Goldman executives knew the firm was selling poor quality assets at inflated prices. Within six months of issuance, AAA Timberwolf securities lost almost 80% of their value. Due to its overall short position in Timberwolf and other mortgage related assets, Goldman profited at the expense of the clients to whom it sold the Timberwolf securities.

C. The Findings of the Senate Subcommittee

268. The Senate Subcommittee found that Goldman's undisclosed conduct in connection with Abacus, Hudson, Anderson and Timberwolf created a clear conflict of interest with Goldman's clients. The Senate Subcommittee found:

> (2) **Magnifying Risk**. Goldman Sachs magnified the impact of toxic mortgages on financial markets by re-securitizing RMBS securities in collateralized debt obligations (CDOs), referencing them in synthetic CDOs, selling the CDO securities to investors, and using credit default swaps and index trading to profit from the failure of the same RMBS and CDO securities it sold.

(3) **Shorting the Mortgage Market**. As high risk mortgage delinquencies increased, and RMBS and CDO securities began to lose value, Goldman Sachs took a net short position on the mortgage market, remaining net short throughout 2007, and cashed in very large short positions, generating billions of dollars in gain.

(4) **Conflict Between Client Interests and Proprietary Trading**. In 2007, Goldman Sachs went beyond its role as market maker for clients seeking to buy or sell mortgage related securities, traded billions of dollars in mortgage related assets for the benefit of the firm without disclosing its proprietary positions to clients, and instructed its sales force to sell mortgage related assets, including high risk RMBS and CDO securities that Goldman Sachs wanted to get off its books, and utilizing key roles in CDO transactions to promote its own interests at the expense of investors, creating a conflict between the firm's proprietary interests and the interests of its clients.

269. Further, according to then-Senate Subcommittee Chairman Sen. Carl Levin:

> Investment banks such as Goldman Sachs were not simply market-makers, they were self-interested promoters of risky and complicated financial schemes that helped trigger the [financial] crisis[.] They bundled toxic mortgages into complex financial instruments, got the credit rating agencies to label them as AAA securities, and sold them to investors, magnifying and spreading risk

throughout the financial system, and all too often betting against the instruments they sold and profiting at the expense of their clients.

270. As set forth below, defendants' undisclosed fraudulent conduct rendered its statements from February 2007 – April 2010 false and misleading.

D. Defendants' False and Material Misstatements and Omissions Which Failed to Disclose Goldman's Conflicts of Interest with Its Clients and the Impact on Goldman's "Best in Class Franchise"

271. On February 6, 2007, Goldman issued its Form 10-K for fiscal year ended November 24, 2006, which was signed by defendants CEO Blankfein and CFO Viniar and represented that:

Trading and Principal Investments

> Trading and Principal Investments represented 68% of 2006 net revenues. . . .
>
> * * *
>
> ***We believe our willingness and ability to take risk to facilitate client transactions distinguishes us from many of our competitors and substantially enhances our client relationships***.
>
> * * *
>
> We generate trading net revenues from our customer-driven businesses in three ways:
>
> - First, in large, highly liquid markets, we undertake a high volume of transactions for modest spreads and fees.

- Second, by capitalizing on our strong relationships and capital position, we undertake transactions in less liquid markets where spreads and fees are generally larger.
- Finally, we structure and execute transactions that address complex ***client needs***.

272. Goldman, in its 2006 Form 10-K, further stated that:

> Conflicts of interest are increasing and a failure to appropriately deal with conflicts of interest could adversely affect our businesses.
>
> ***Our reputation is one of our most important assets***. As we have expanded the scope of our businesses and our client base, we increasingly have to address potential conflicts of interest, including situations where our services to a particular client or our own proprietary investments or other interests conflict, or are perceived to conflict, with the interests of another client, as well as situations where one or more of our businesses have access to material non-public information that may not be shared with other businesses within the firm.
>
> * * *
>
> ***We have extensive procedures and controls that are designed to address conflicts of interest***, including those designed to prevent the improper sharing of information among our businesses. However, appropriately dealing with conflicts of interest is complex and difficult, and ***our reputation could be damaged and the***

> ***willingness of clients to enter into transactions in which such a conflict might arise may be affected if we fail, or appear to fail, to deal appropriately with conflicts of interest. In addition, potential or perceived conflicts could give rise to litigation or enforcement actions.***

273. In its 2006 Form 10-K, Goldman stressed the various committees that monitored the Company's business practices and purportedly ensured that Goldman conducted itself with the highest priority. Specifically, Goldman represented that its "Business Practices Committee" assisted senior management in its oversight of compliance and operational risks and related ***reputational*** concerns and that "the Business Practices Committee also reviews Goldman Sachs' business practices, policies and procedures for consistency with our business principles."

274. Goldman also represented in its 2006 Form 10-K that a separate committee, the "Commitments Committee," reviewed and approved underwriting and distribution activities, primarily with respect to offerings of equity and equity-related securities, and "sets and maintains policies and procedures designed to ensure that legal, ***reputational***, regulatory and business standards are maintained in conjunction with these activities."

275. Goldman further stated in its 2006 Form 10-K that's its "Structured Products Committee" reviewed and approved structured product transactions entered into with clients that "raise legal, regulatory, tax or accounting issues or present ***reputational*** risk to Goldman Sachs."

276. The above statements were materially false and misleading because defendants failed to disclose Goldman's fraudulent conduct and conflicts of interest with its clients in connection with Hudson, Anderson, Timberwolf and Abacus, including that Goldman had (i) identified toxic mortgage-backed securities and CDOs held on its books that Goldman believed would significantly decline in value and cause the firm to lose billions; (ii) packaged and sold these securities to Goldman's own clients in order to shift the risks posed by those toxic assets from Goldman's books onto those of its clients, and not in response to client demand; (iii) made affirmative misrepresentations to its own clients in order to hide the fact that Goldman had bet against these securities; and (iv) made billions at its own clients' expense when the value of these securities plummeted, just as Goldman anticipated they would. They also omitted the known fact that Goldman was engaged in direct conflicts of interest with its clients, while Goldman warned that such conflicts could only "potentially" arise. These statements were further materially false and misleading because Goldman did not adequately monitor the business conduct of its employees. Indeed, senior management openly instructed employees to shift the risks of toxic mortgage-backed securities from Goldman's books on to investors, which when ultimately disclosed caused severe ***reputational*** damage to Goldman's client franchise. These statements were also materially false and misleading for the reasons stated in ¶¶148-270.

277. On February 21, 2007 Goldman issued its 2006 Annual Report to Shareholders, which contained "The Goldman Sachs Business Principles," including:

> 1 ***Our clients' interests always come first.*** Our experience shows that if we serve our clients well, our own success will follow.
>
> 2 Our assets are our people, capital and ***reputation. If any of these is ever diminished, the last is the most difficult to restore. We are dedicated to complying fully with the letter and spirit of the laws, rules and ethical principles that govern us. Our continued success depends upon unswerving adherence to this standard***.
>
> * * *
>
> 14 ***Integrity and honesty are at the heart of our business***.

278. The above statements were materially false and misleading for reasons stated in ¶¶148-276 above.

279. On March 13, 2007, Goldman held an investor conference call to discuss its first quarter 2007 results. CFO Viniar told investors: "[Our] record results for the first quarter, . . . reflects the depth of our client franchise and the diversity of our business mix." The above statement was materially false and misleading for the reasons stated in ¶¶148-278 above.

280. On June 14, 2007, Goldman held an investor conference call to discuss its second quarter 2007 results, Goldman CFO Viniar stressed that it was "another strong quarter" for the Company:

> Most importantly, and ***the basic reason for our success, is our extraordinary focus on our clients***.

The above statements was materially false and misleading for the reasons stated in ¶¶148-279 above.

281. On November 13, 2007, Goldman CEO Blankfein told investors at the 2007 Merrill Lynch Banking and Financial Investor Services Conference that:

> ***What drove performance was the quality of our client franchise***. To me, franchise describes the extent to which ***our clients come to us for help, advice, and execution. From those relationships, business opportunities are brought to the firm***.

The above statements were materially false and misleading for the reasons stated in ¶¶148-280 above.

282. On December 18, 2007, Goldman held an investor conference call to discuss fourth quarter 2007 results. Goldman CFO Viniar highlighted that Goldman's client franchise and reputation allowed the Company to continue to flourish in the midst of the subprime meltdown unlike its main competitors:

> In light of the recently more challenging market conditions, ***our record results demonstrate*** the diversity of our business mix, the breadth of our global footprint and most importantly ***the strength of the Goldman Sachs client franchise***.
>
> * * *
>
> FICC produced another record year in arguabl[y] the most challenging mortgage and credit markets [we] have seen in almost a decade. ***At the core of fixed success is the strength of its clients franchise***.

The above statement was materially false and misleading for the reasons stated in ¶¶148-281 above.

283. On January 29, 2008, Goldman issued its Form 10-K for fiscal year ended November 30, 2007 which was signed by defendants CEO Blankfein and CFO Viniar and represented that:

> **Trading and Principal Investments**
>
> Trading and Principal Investments represented 68% of 2007 net revenues.
>
> * * *
>
> ***We believe our willingness and ability to take risk to facilitate client transactions distinguishes us from many of our competitors and substantially enhances our client relationships***.
>
> * * *
>
> We generate trading net revenues from our ***customer-driven*** businesses in three ways:
>
> - First, in large, highly liquid markets, we undertake a high volume of transactions for modest spreads and fees.
> - Second, by capitalizing on our strong relationships and capital position, we undertake transactions in less liquid markets where spreads and fees are generally larger.
> - Finally, we structure and execute transactions that address complex client needs.

284. In its 2007 Form 10-K, Goldman further stated that:

Conflicts of interest are increasing and a failure to appropriately identify and deal with conflicts of interest could adversely affect our businesses.

Our reputation is one of our most important assets. As we have expanded the scope of our businesses and our client base, we increasingly have to address potential conflicts of interest, ***including situations where our services to a particular client or our own proprietary investments or other interests conflict, or are perceived to conflict, with the interests of another client***, as well as situations where one or more of our businesses have access to material non-public information that may not be shared with other businesses within the firm.

* * *

We have extensive procedures and controls that are designed to identify and address conflicts of interest, including those designed to prevent the improper sharing of information among our businesses. However, appropriately identifying and dealing with conflicts of interest is complex and difficult, and ***our reputation could be damaged and the willingness of clients to enter into transactions in which such a conflict might arise may be affected if we fail, or appear to fail, to identify and deal appropriately with conflicts of interest. In addition, potential or perceived conflicts could give rise to litigation or enforcement actions***.

285. In its 2007 Form 10-K, Goldman touted the various committees that monitored the Company's business practices. Specifically, Goldman represented in its annual SEC filings that its "Business Practices Committee" assisted senior management in its oversight of compliance and operational risks and related ***reputational*** concerns, in order to "ensure the consistency of our policies, practices and procedures with our Business Principles."

286. Goldman also represented in its 2007 Form 10-K that a separate committee, the "Commitments Committee," reviewed and approved underwriting and distribution activities, primarily with respect to offerings of equity and equity-related securities, and "sets and maintains policies and procedures designed to ensure that legal, ***reputational***, regulatory and business standards are maintained in conjunction with these activities."

287. Goldman further stated in its 2007 Form 10-K that's its "Structured Products Committee" reviewed and approved structured product transactions entered into with clients that "raise legal, regulatory, tax or accounting issues or present ***reputational*** risk to Goldman Sachs."

288. The above statements were materially false and misleading for the reasons stated in ¶¶148-282 above.

289. On March 7, 2008, Goldman issued its 2007 Annual Report to Shareholders which contained "The Goldman Sachs Business Principles," including:

> 1 ***Our clients' interests always come first***. Our experience shows that if we serve our clients well, our own success will follow.

> 2 ***Our assets*** are our people, capital and ***reputation***. ***If any of these is ever diminished, the last is the most difficult to restore***. ***We are dedicated to complying fully with the letter and spirit of the laws, rules and ethical principles that govern us***. ***Our continued success depends upon unswerving adherence to this standard***.
>
> * * *
>
> 14 ***Integrity and honesty are at the heart of our business***.

290. The above statements were materially false and misleading for the reasons stated in ¶¶148-288 above.

291. On March 18, 2008, Goldman held an investor conference call to discuss first quarter results. CEO Viniar stated:

> However, given the significant weakness in the broader market environment during the first quarter, ***we believe our results clearly demonstrate value of the Goldman Sachs client franchise*** and business model, as well as our culture of teamwork and risk management.

The above statement was materially false and misleading for the reasons stated in ¶¶148-290 above.

292. On September 16, 2008 Goldman held an investor call to discuss its third quarter 2008 results. CFO Viniar stated:

> Through our financial performance as a public company, we have repeatedly demonstrated the benefits of having a deep

> and broad franchise. It is this business model and franchise which, despite the challenging environment, generated a return on equity of nearly 19% over the past four quarters.
>
> * * *
>
> While I cannot predict the near-term macro environment, ***I can assure you that Goldman Sachs has never been closer to our clients*** or better positioned to face tough markets and take advantage of profitable opportunities. ***We will continue to manage this firm with our focus utmost on protecting this valuable franchise***.

The above statements were materially false and misleading for the reasons stated in ¶¶148-291 above.

293. On January 27, 2009, Goldman issued its Form 10-K for fiscal year ended November 30, 2008 which was signed by defendants CEO Blankfein and CFO Viniar and represented that:

Trading and Principal Investments

> Trading and Principal Investments represented 41% of 2008 net revenues.
>
> * * *
>
> ***We believe our willingness and ability to take risk to facilitate client transactions distinguishes us from many of our competitors and substantially enhances our client relationships***.
>
> * * *
>
> We generate trading net revenues from our client-driven businesses in three ways:

- First, in large, highly liquid markets, we undertake a high volume of transactions for modest spreads and fees.
- Second, by capitalizing on our strong relationships and capital position, we undertake transactions in less liquid markets where spreads and fees are generally larger.
- Finally, we structure and execute transactions that address complex client needs.

294. Goldman, in its 2008 Form 10-K, further stated that:

> Conflicts of interest are increasing and a failure to appropriately identify and deal with conflicts of interest could adversely affect our businesses. As we have expanded the scope of our businesses and our client base, we increasingly must address potential conflicts of interest, ***including situations where our services to a particular client or our own investments or other interests conflict, or are perceived to conflict, with the interests of another client***, as well as situations where one or more of our businesses have access to material non-public information that may not be shared with other businesses within the firm and situations where we may be a creditor of an entity with which we also have an advisory or other relationship.
>
> * * *
>
> ***We have extensive procedures and controls that are designed to identify and address conflicts of interest***, including

> those designed to prevent the improper sharing of information among our businesses. However, appropriately identifying and dealing with conflicts of interest is complex and difficult, and our reputation, which is one of our most important assets, could be damaged and the willingness of clients to enter into transactions in which such a conflict might arise may be affected if we fail, or appear to fail, to identify and deal appropriately with conflicts of interest. In addition, potential or perceived conflicts could give rise to litigation or enforcement actions.

295. In its 2008 Form 10-K, Goldman also touted the various committees that monitored the Company's business practices. Specifically, Goldman represented in its annual SEC filings that its "Business Practices Committee" assisted senior management in its oversight of compliance and operational risks and related ***reputational*** concerns, in order to "ensure the consistency of our policies, practices and procedures with our Business Principles."

296. Goldman also represented in its 2008 Form 10-K that a separate committee, the "Commitments Committee," reviewed and approved underwriting and distribution activities, primarily with respect to offerings of equity and equity-related securities, and "sets and maintains policies and procedures designed to ensure that legal, ***reputational***, regulatory and business standards are maintained in conjunction with these activities."

297. Goldman further stated in its 2008 Form 10-K that's its "Structured Products Committee" reviewed and approved structured product transactions entered into with clients that "raise legal, regulatory, tax or

accounting issues or present ***reputational*** risk to Goldman Sachs."

298. The above statements were materially false and misleading for the reasons stated in ¶¶148-292 above.

299. On April 6, 2009 Goldman issued its 2008 Annual Report to Shareholders which contained "The Goldman Sachs Business Principles," including:

> 1 ***Our clients' interests always come first***. Our experience shows that if we serve our clients well, our own success will follow.
>
> 2 Our assets are our people, capital and ***reputation. If any of these is ever diminished, the last is the most difficult to restore. We are dedicated to complying fully with the letter and spirit of the laws, rules and ethical principles that govern us. Our continued success depends upon unswerving adherence to this standard***.
>
> * * *
>
> 14 ***Integrity and honesty are at the heart of our business***.

300. The above statements were materially false and misleading for the reasons stated in ¶¶148-298 above.

301. On July 14, 2009 Goldman held an investor conference call to discuss its second quarter 2009 results. CFO Viniar stated:

> For the past two years, we've operated in an extremely challenging environment. ***Our performance in this cycle has been guided by several principles, including***

> ***putting our clients' needs first***, executing our stated strategy and acting as a good steward of the Firm. ***We adhere to these philosophies to enhance and preserve our franchise*** and protect the interest of our shareholders. These are longstanding principles, and we remain committed to them.

The above statements were materially false and misleading for the reasons stated in ¶¶148-300 above.

302. Goldman, in its 2009 Form 10-K, which was issued on February 26, 2010, stated that:

Trading and Principal Investments

> Trading and Principal Investments represented 76% of 2009 net revenues. . . .
>
> ***We believe our willingness and ability to take risk to facilitate client transactions distinguishes us from many of our competitors and substantially enhances our client relationships***.
>
> * * *
>
> We generate trading net revenues from our ***client-driven*** businesses in three ways:
>
> - First, in large, highly liquid markets, we undertake a high volume of transactions for modest spreads and fees.
> - Second, by capitalizing on our strong relationships and capital position, we undertake transactions in less liquid markets where spreads and fees are generally larger.
> - Finally, we structure and execute transactions that address complex ***client needs***.

303. Goldman, in its 2009 Form 10-K, further stated that:

> Conflicts of interest are increasing and a failure to appropriately identify and deal with conflicts of interest could adversely affect our businesses. As we have expanded the scope of our businesses and our client base, we increasingly must address potential conflicts of interest, ***including situations where our services to a particular client or our own investments or other interests conflict, or are perceived to conflict, with the interests of another client***, as well as situations where one or more of our businesses have access to material non-public information that may not be shared with other businesses within the firm and situations where we may be a creditor of an entity with which we also have an advisory or other relationship. . . .
>
> ***We have extensive procedures and controls that are designed to identify and address conflicts of interest***, including those designed to prevent the improper sharing of information among our businesses. However, appropriately identifying and dealing with conflicts of interest is complex and difficult, and ***our reputation, which is one of our most important assets, could be damaged and the willingness of clients to enter into transactions in which such a conflict might arise may be affected if we fail, or appear to fail, to identify and deal appropriately with conflicts of interest. In addition,***

> ***potential or perceived conflicts could give rise to litigation or regulatory enforcement actions***.

304. The above statements were materially false and misleading for the reasons stated in ¶¶148-301 above.

305. On April 7, 2010, Goldman issued its 2009 Annual Report to Shareholders which contained "The Goldman Sachs Business Principles," including:

> 1 ***Our clients' interests always come first***. Our experience shows that if we serve our clients well, our own success will follow.
>
> 2 Our assets are our people, capital and ***reputation. If any of these is ever diminished, the last is the most difficult to restore. We are dedicated to complying fully with the letter and spirit of the laws, rules and ethical principles that govern us. Our continued success depends upon unswerving adherence to this standard***.
>
> * * *
>
> 14 ***Integrity and honesty are at the heart of our business***.

306. The above statements were materially false and misleading for the reasons stated in ¶¶148-304 above.

IX. THE TRUTH REGARDING GOLDMAN'S FRAUDULENT CONDUCT IS REVEALED

307. On April 16, 2010, shortly after the market opened, the SEC filed a complaint charging Goldman with securities fraud in connection with the Abacus CDO. The SEC alleged:

The Commission brings this securities fraud action against Goldman, Sachs & Co. ("GS&Co") and a GS&Co employee, Fabrice Tourre ("Tourre"), for making ***materially misleading statements and omissions in connection with a synthetic collateralized debt obligation*** ("CDO") GS&Co structured and marketed to investors. This synthetic CDO, Abacus 2007AC1, was tied to the performance of subprime residential mortgage-backed securities ("RMBS") and was structured and marketed by GS&Co in early 2007 when the United States housing market and related securities were beginning to show signs of distress. Synthetic CDOs like Abacus 2007-AC1 contributed to the recent financial crisis by magnifying losses associated with the downturn in the United States housing market.

GS&Co marketing materials for Abacus 2007-AC1 – including the term sheet, flip book and offering memorandum for the CDO – ***all represented that the reference portfolio of RMBS underlying the CDO was selected by ACA Management LLC*** ("ACA"), a third-party with experience analyzing credit risk in RMBS. ***Undisclosed*** in the marketing materials and ***unbeknownst to investors***, a large hedge fund, Paulson & Co. Inc. ("Paulson"), with economic interests directly adverse to investors in the Abacus 2007-AC1 CDO, played a significant role in the portfolio selection process. After participating in the

> selection of the reference portfolio, Paulson effectively shorted the RMBS portfolio it helped select by entering into credit default swaps ("CDS") with GS&Co to buy protection on specific layers of the Abacus 2007-AC1 capital structure. Given its financial short interest, Paulson had an economic incentive to choose RMBS that it expected to experience credit events in the near future. ***GS&Co did not disclose Paulson's adverse economic interests or its role in the portfolio selection process in the term sheet, flip book, offering memorandum or other marketing materials provided to investors***.
>
> * * *
>
> By engaging in the misconduct described herein, GS&Co and Tourre directly or indirectly engaged in transactions, acts, practices and a course of business that violated Section 17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a) ("the Securities Act"), Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b)("the Exchange Act") and Exchange Act Rule 10b-5, 17 C.F.R. §240.10b-5. The Commission seeks injunctive relief, disgorgement of profits, prejudgment interest, civil penalties and other appropriate and necessary equitable relief from both defendants.

308. Upon this news, Goldman stock immediately declined, ultimately falling from $184.27 per share on April 15, 2010 to $160.70 per share on April 16, 2010, a decline of 13% on extremely high volume of 101.9

million shares. Shareholders suffered a $13 billion dollar loss in the value.

309. Market analysts estimated that the financial impact to Goldman of the SEC lawsuit was approximately $1 billion, reflecting the potential penalties relating to the Abacus deal.

310. The $13 billion loss in shareholder value in Goldman's stock on April 16, 2010, immediately following the filing of the SEC fraud suit grossly exceeded the $1 billion estimated "worst case" financial impact to Goldman from an unfavorable verdict in the SEC fraud suit.

311. Despite this undeniable fact, on April 20, 2010, Goldman Co-General Counsel Gregory Palm told the public that Goldman's failure to disclose the fact that it knew as soon as July 2009 that the SEC intended to bring securities fraud charges was justified because Goldman did not consider the Wells Notice to be material:

> [W]hat I would say about that is our policy has always been to disclose to our investors everything that we consider to be material. And that would include investigations, obviously lawsuits, regulatory matters, anything. Whether there is a Wells or not a Wells, if we consider it to be material we go ahead and disclose it and that is our policy. To get to your question we do not disclose every Wells we get simply because that wouldn't make sense. Therefore we just disclose it if we consider it to be material.

312. Market commentary further confirmed what the $13 billion dollar loss in shareholder value already established – that the financial impact to Goldman

due to the SEC fraud charge was obviously material and not limited to the potential penalties relating to Abacus. Rather, when the SEC's fraud charge revealed Goldman's undisclosed conduct of betting against its clients to make billions, Goldman suffered severe harm and investors punished the stock accordingly.

313. On April 16, 2010, Professor John Coffee, one of the leading and renowned defense experts in the securities fraud area told *Dow Jones*:

> "These charges are far more severe than anyone had imagined," and suggest Goldman teamed with "the leading short-seller in the industry to design a portfolio of securities that would crash," said ***John Coffee***, a securities law professor at Columbia Law School in New York.
>
> "***The greatest penalty for Goldman is not the financial damages – Goldman is enormously wealthy – but the reputational damage***," he said, adding that "it's not impossible" to contemplate that the case could lead to criminal charges.

314. Market analysts agreed with Professor Coffee:

- April 19, 2010 Macquarie (USA) Equities Research

> Normally, firms settle with the SEC to avoid the risk of losing in court, which would tee-up huge class-action wins. However, in this case, the losses only total $1bn. ***Typically, reputational damage, particularly in the institutional context, is a paper tiger. However, in this case, the response by the media and Washington***

has been so severe, that we believe management will want their day in court to prove the firm's innocence. As a result, we may not see the typical settlement but a trial.

As for the direct financial impact, the worst-case scenario is probably $1.10/sh or 6% of our 2010 estimate while there were no material expectations for synthetic CDO revenue in forward estimates. ***As for reputation, Goldman clients are "eyes-wide-open"***.

- April 22, 2010 the *Times (London)*

There were signs yesterday that the scandal was costing Goldman business. BayernLB, one of Germany's biggest banks, said that it would stop dealing with Goldman with immediate effect.

315. Moody's, one of the largest credit rating agencies, confirmed that the damage caused by the SEC lawsuit went well beyond the potential $1 billion penalty relating to Abacus:

April 19, 2010 Moody's Weekly Credit Outlook Report:

On Friday morning in a civil complaint, the SEC accused Goldman Sachs (A1, negative) of fraud in the marketing and origination of a synthetic collateralized debt obligation (CDO). Later on Friday, Goldman Sachs denied the SEC's allegations. ***This development is a credit negative for Goldman Sachs given the potential franchise implications and direct financial costs***.

316. Between April 16, 2010 and June 10, 2010, Goldman suffered additional significant stock price declines. On April 25-26, 2010, the Senate Subcommittee released Goldman internal emails further detailing that Goldman made billions by betting against the CDOs it sold to its clients.

317. Upon the disclosure of this new information relating to Goldman's fraudulent conduct, on April 26, 2010, Goldman stock declined approximately 3.5% from $157.40 to $152.03.

318. On April 29, 2010, two days after ten Goldman executives, including CEO Blankfein, CFO Viniar, COO Cohn, and Mortgage Department Head Daniel Sparks testified before the Senate Subcommittee and vehemently denied that they had done anything wrong, the *Wall Street Journal* reported that Goldman was the subject of a criminal investigation by the Department of Justice.

319. Upon the disclosure of this news on April 30, 2010, Goldman suffered an approximate 9.5% stock price decline from $160.24 to $145.20.

320. Market commentary again confirmed that this new information caused Goldman's stock to decline.

321. On May 5, 2010 Fitch Ratings lowered Goldman's "Ratings Outlook" from "Stable" to "Negative," stating:

> ***The Rating Outlook revision to Negative incorporates recent legal developments and ongoing regulatory challenges that could adversely impact Goldman's reputation and revenue generating capacity. Goldman's franchise and market position are***

potentially vulnerable to scrutiny by stakeholders, and like peers, may be affected by the industry's regulatory evolution.

Subsequent to civil fraud charges filed by the Securities and Exchange Commission (SEC) last month, it appears that the U.S. Attorney's Office in Manhattan is initiating a criminal probe in connection with Goldman's mortgage trading activity. Given the level of recent public scrutiny, it is not surprising that other authorities outside of the U.S. have also expressed intentions to investigate select mortgage-related transactions conducted by Goldman. At a minimum, ***Fitch believes the civil charges to date and the pending criminal investigation, coupled with a highly public hearing by the U.S. Senate's Permanent Subcommittee on Investigations, generate adverse publicity that tarnishes Goldman's reputation. And for financial services companies, particularly those dependent on the capital markets, reputation is critically important***.

322. On June 10, 2010, it was reported that the SEC was investigating whether in connection with the Hudson CDO, Goldman profited by ridding itself of mortgage backed securities and related CDO's on Goldman's books that it knew were going to decline by selling these securities to Goldman's clients who suffered billions in losses. Goldman stock fell over 2%, from $136.80 to $133.77.

323. Market commentary again confirmed that the negative news which began with the filing of the SEC

fraud suit on April 16, 2010 had caused severe damage to Goldman's stock price:

- June 11, 2010 *Reuters Hedgeworld (New York)*

To date, the regulatory scandal, which began with the filing of the SEC lawsuit on April 16, has cost Goldman $25 billion in market capitalization.

- July 19, 2010 *Wall Street Journal Europe*

The SEC's fraud accusations hurt Goldman in the battle for some plum assignments, people familiar with the matter said.

Investment bankers up and down Wall Street spent months courting General Motors Co. and the U.S. government to handle the auto maker's expected initial public offering later this year.

Goldman President Gary D. Cohn flew to Washington to make the case that Goldman should be considered to lead the deal. ***But the firm couldn't overcome the black eye inflicted by the SEC's*** suit over Goldman's creation and sale of a mortgage-securities deal called **Abacus** 2007-AC1, according to people familiar with the discussions.

- June 23, 2010 *HedgeWorld Daily News*

The firm has already taken some hits. Goldman didn't make the cut as a lead underwriter on a $300 million initial public offering for consulting firm Booz Allen Hamilton, said people familiar with the situation. The Carlyle Group,

> ***the private equity firm which acquired Booz Allen in a $2.54 billion buyout, was worried about the public perception of Goldman leading an IPO for a company with close ties to the U.S. Department of Defense***.

X. LOSS CAUSATION/ECONOMIC LOSS

324. During the Class Period, defendants made numerous false and misleading statements and omissions of material facts necessary to render those statements not false or misleading, which artificially inflated Goldman's stock price.

325. These include the three categories of Goldman's materially false and misleading statements and omissions made during the Class Period.

326. First, from July 2009 until April 2010 Goldman concealed from its quarterly and year-end SEC filings, press releases and investor conference calls that the Company had been notified in July 2009, via a formal Wells Notice, that the SEC had recommended filing securities fraud charges relating to Goldman's conduct in connection with Abacus. By failing to disclose the Wells Notice, Goldman hid its improper conduct of betting against (or allowing a favored client to bet against) the very toxic securities that Goldman designed to fail and packaged and sold to its clients.

327. Second, from February 7, 2007 through April 2010, Goldman reassured investors that "***[w]e have extensive procedures and controls that are designed to [identify and] address conflicts of interest*** . . . ." Goldman's statements were false and misleading and omitted the fact that the Company was

engaged in pervasive conflicts of interest, including that Goldman had designed Abacus to allow a favored client to benefit at the expense of Goldman's other clients.

328. Third, Goldman repeatedly told the public that its client franchise and continued success depended on the Company's reputation, honesty, integrity and commitment to put its clients' interests first above all else, all while concealing that the Company had (i) identified toxic mortgage-backed and CDOs held on its books that Goldman believed would significantly decline in value and cause the firm to lose billions; (ii) created clear conflicts of interest by packaging and selling these securities to Goldman's own clients in order to shift the risk posed by these toxic assets from Goldman's books onto those of its clients; (iii) hid and made affirmative misrepresentations which obscured the fact that Goldman had bet against these securities; and (iv) made billions at its own clients' expense when the value of these securities; plummeted, just as Goldman anticipated they would.

329. Lead Plaintiffs and investors purchased Goldman stock at these inflated prices and suffered damages when the price of Goldman stock declined upon the revelations of the truth, in contrast to earlier misstatements.

330. The inflation in Goldman's stock was dissipated through a series of partial disclosures of the truth that revealed that, contrary to its representations, the Company had engaged in the abusive conduct of placing the Company's interests above its own clients. The resulting significant stock price declines upon release of truthful information were due to firm-specific fraud related disclosures, and not a result of market or industry. The following

examples are not exhaustive because fact and expert discovery have yet to commence:

331. On April 16, 2010 the SEC filed its securities fraud case against Goldman, which revealed that Goldman's had collaborated with a favored client to design a portfolio of securities that would decline in value, and sold this toxic portfolio to other Goldman clients. The SEC's fraud charge inflicted severe damage. Upon this news, Goldman stock immediately declined, ultimately falling from $184.27 per share on April 15, 2010 to $160.70 per share on April 16, 2010, a decline of 13% on extremely high volume of 102 million shares – while the S&P 500 was down only 1.6% and the S&P 500 financials was down only 3.9%. Shareholders suffered a $13 billion dollar loss in the value of Goldman stock.

332. The $13 billion loss in shareholder value in Goldman's stock on April 16, 2010, immediately following the filing of the SEC fraud suit grossly exceeded the $1 billion estimated "worst case" financial impact to Goldman from an unfavorable verdict in the SEC fraud suit.

333. On April 25-26, 2010, the Senate Subcommittee released Goldman internal emails further revealing that Goldman's practice of betting against the very securities it sold to its clients. Upon the disclosure of this new material information on April 26, 2010, Goldman stock declined approximately 3.5% from $157.40 to $152.03, while the S&P 500 was down only .4% and the S&P 500 financials was down only 1.7%.

334. On April 29, 2010, two days after ten Goldman executives, including CEO Blankfein, CFO Viniar, COO Cohn, and Mortgage Department Head Daniel

Sparks testified before the Senate Subcommittee and vehemently denied that they had done anything wrong or illegal whatsoever, the *Wall Street Journal* reported that Goldman was the subject of a criminal investigation by the Department of Justice. Upon the disclosure of this new material information, on April 30, 2010, Goldman suffered an approximate 9.5% stock price decline from $160.24 to $145.20, while the S&P 500 was down only 1.7% and the S&P 500 financials was down only 2.5%.

335. On June 10, 2010, it was reported that the SEC was investigating whether in connection with the Hudson CDO, Goldman profited by ridding itself of mortgage backed securities and related CDO's on Goldman's books that it knew were going to decline by selling these securities to Goldman's clients who suffered billions in losses. Upon disclosure of this new material information, on June 10, 2010, Goldman stock fell over 2%, from $136.80 to $133.77, while the S&P 500 was up 2.9% and the S&P 500 financials was up 3.3%.

XI. APPLICABILITY OF PRESUMPTION OF RELIANCE FRAUD ON THE MARKET DOCTRINE

336. At all relevant times, the market for Goldman's common stock was an efficient market for the following reasons, among others:

(i) Goldman stock met the requirements for listing, and was listed and actively traded on the NYSE, a highly efficient and automated market;

(ii) As a regulated issuer, Goldman filed periodic public reports with the SEC and the NYSE;

(iii) Goldman regularly communicated with public investors via established market communication mechanisms, including through regular disseminations of press releases on the national circuits of major newswire services and through other wide-ranging public disclosures, such as communications with the financial press and other similar reporting services;

(iv) Goldman was followed by securities analysts employed by major brokerage firms who wrote reports that were distributed to the sales force and certain customers of their respective brokerage firms. Each of these reports was publicly available and entered the public marketplace; and

(v) Goldman's stock price reacted to the disclosure of firm specific news about the Company.

337. As a result of the foregoing, the market for Goldman's common stock promptly digested current information regarding Goldman from all publicly available sources and reflected such information in Goldman's stock price. Under these circumstances, all purchasers of Goldman's common stock during the Class Period suffered similar injury through their purchase of Goldman's common stock at artificially inflated prices and a presumption of reliance applies.

COUNT I

For Violation of §10(b) of the Exchange Act and Rule 10b-5 Against All Defendants

338. Lead Plaintiffs incorporate ¶¶1-337 by reference.

339. During the Class Period, defendants disseminated or approved the false statements specified above, which they knew or deliberately disregarded were misleading in that they contained misrepresentations and failed to disclose material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

340. Defendants violated §10(b) of the Exchange Act and Rule 10b-5 in that they:

(a) employed devices, schemes and artifices to defraud;

(b) made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(c) engaged in acts, practices and a course of business that operated as a fraud or deceit upon Lead Plaintiffs and others similarly situated in connection with their purchases of Goldman common stock during the Class Period.

341. Lead Plaintiffs and the Class have suffered damages in that, in reliance on the integrity of the market, they paid artificially inflated prices for Goldman common stock. Lead Plaintiffs and the Class would not have purchased Goldman common stock at

the prices they paid, or at all, if they had been aware that the market prices had been artificially and falsely inflated by defendants' misleading statements.

COUNT II

For Violation of §20(a) of the Exchange Act Against All Defendants

342. Lead Plaintiffs incorporate ¶¶1-341 by reference.

343. The Individual Defendants acted as controlling persons of Goldman within the meaning of §20(a) of the Exchange Act. By reason of their positions with the Company, and their ownership of Goldman stock, the Individual Defendants had the power and authority to cause Goldman to engage in the wrongful conduct complained of herein. Goldman controlled the Individual Defendants and all of its employees. By reason of such conduct, defendants are liable pursuant to §20(a) of the Exchange Act.

PRAYER FOR RELIEF

WHEREFORE, Lead Plaintiffs pray for judgment as follows:

A. Declaring this action to be a proper class action pursuant to Fed. R. Civ. P. 23;

B. Awarding Lead Plaintiffs and the members of the Class damages, including interest;

C. Awarding Lead Plaintiffs' reasonable costs and attorneys' fees; and

D. Awarding such equitable/injunctive or other relief as the Court may deem just and proper.

JURY DEMAND

Lead Plaintiffs demand a trial by jury.

DATED: July 25, 2011

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

10 Civ. 3461 (PAC)

ILENE RICHMAN, Individually and on behalf of all others similarly situated,

Plaintiffs,

-against-

GOLDMAN SACHS GROUP, INC, *et al*.,

Defendants.

OPINION & ORDER

HONORABLE PAUL A. CROTTY, United States District Judge:

Plaintiffs in this class action allege that Goldman Sachs & Co. ("Goldman"), Lloyd C. Blankfein, David A. Viniar, and Gary D. Cohn (the "Individual Defendants," and collectively with Goldman, the "Defendants") violated § 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder (Count One); and § 20(a) of the Exchange Act (Count II). Plaintiffs, who are purchasers of Goldman's common stock during the period February 5, 2007 through June 10, 2010, claim that Defendants made material misstatements and omissions regarding: (1) Goldman's receipt of "Wells Notices" from the Securities and Exchange Commission ("SEC") relating to Goldman's role in the synthetic collateralized debt obligation ("CDO"), titled ABACUS 2007 AC-1 ("Abacus"); and (2) Goldman's conflicts of interest that arose from its role in the Abacus, Hudson Mezzanine Funding 2006-1

("Hudson"), The Anderson Mezzanine Funding 2007-1 ("Anderson"), and Timberwolf I CDO transactions.

Defendants move, pursuant to Fed. R. Civ. P. 9(b) and 12(b)(6), to dismiss the Consolidated Class Action Complaint (the "Complaint"). For the following reasons, Defendants' motion with respect to the failure to disclose the Wells Notices is GRANTED, and otherwise DENIED.

BACKGROUND

I. Abacus and the SEC Investigation

On April 26, 2007, the Abacus synthetic CDO transaction closed.[1] Goldman served as the underwriter or placement agent, the lead manager, and the protection buyer for the Abacus transaction. (Compl. ¶ 50 & n.3.) Plaintiffs claim that "the Abacus transaction [ ] was designed from the outset by [Goldman] to allow a favored client to benefit at the expense of Goldman's other clients." (*Id.* ¶ 147.) Specifically, Plaintiffs claim that Goldman allowed Paulson & Co., a hedge fund client, to "play[ ] an active and determinative role in the selection process," and knew that Paulson was picking assets that it "believed would perform poorly or fail." (*Id.* ¶¶ 53, 64.) Indeed,

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[1] In a typical CDO, a special purpose vehicle ("SPV") issues notes and uses the proceeds to acquire a portfolio of assets, such as residential mortgage-backed securities ("RMBS"). The SPV makes payments to noteholders from the income generated by the underlying assets. In a synthetic CDO, the SPV contains a CDO and credit default swap ("CDS"). The SPV obtains derivative exposure to a "reference" portfolio—which may be RMBS or CDOs—by entering into a CDS, pursuant to which counterparties agree to make periodic payments to the SPV in exchange for commitment by the SPV to make payments to the counterparties in the event that the reference securities experience adverse credit events. (*See* Compl. ¶ 50 & n.3.)

"Paulson had agreed to pay Goldman a higher fee if Goldman could provide Paulson with CDS contracts containing premium payments below a certain level." (*Id.* ¶ 77.) Rather than disclose Paulson's role in the asset selection process, Goldman "falsely identified ACA [Management LLC] as the only portfolio selection agent for the CDO." (*Id.* ¶¶ 59-66.) Goldman hid Paulson's role, because it "expect[ed] to leverage ACA's credibility and franchise to help distribute this Transaction." (*Id.* ¶ 61 (quoting a Goldman internal memorandum)). The Abacus transaction performed poorly, as Paulson intended; the investors lost approximately $1 billion, and Paulson, holding the sole short position, profited by this amount. (*Id.* ¶ 81.)

In August 2008, the SEC notified Goldman that it had commenced an investigation into Abacus and served Goldman with a subpoena. (Compl. ¶ 88.) Goldman disclosed in its SEC filings that it had "received requests for information from various governmental agencies and self-regulatory organizations relating to subprime mortgages, and securitizations, collateralized debt obligations and synthetic products relating to subprime mortgages" and that Goldman was "cooperating with the requests." (*Id.* ¶¶ 129, 130.) On July 29, 2009, the SEC issued a Wells Notice to Goldman, notifying it that the SEC's Enforcement Division staff "intends to recommend an enforcement action" and providing Goldman with "an opportunity to respond concerning the recommendation." (*Id.* ¶ 90.) On September 10 and 25, 2009, Goldman provided written Wells submissions to the SEC. (*Id.* ¶ 91.) Goldman thereafter met with the SEC on numerous occasions. (*Id.* ¶ 91.) Plaintiffs claim that by failing to disclose its receipt of a Wells Notice, Goldman "hid its improper conduct of betting against" its clients, and caused its stock to trade at artificially inflated levels. (*Id.* ¶¶ 49, 99.)

On September 28, 2009 and January 29, 2010, the SEC issued Wells Notices to Fabrice Tourre and Jonathan Egol, two Goldman employees involved in the Abacus transaction. (*Id.* ¶¶ 93, 94.) On April 16, 2010, the SEC filed a complaint against Goldman and Tourre—but not Egol—alleging securities fraud violations. (*Id.* ¶ 83.) As a result, Goldman's stock dropped from $184.27 to $160.70 per share, a drop of approximately 13%. (*Id.* ¶ 99.)

On July 14, 2010, Goldman reached a $550 million settlement with the SEC, in which Goldman acknowledged that its marketing material was incomplete and that it had made a mistake:

> [T]he marketing material for the ABACUS 2001-AC1 transaction contained incomplete information. In particular, it was a mistake for the Goldman marketing materials to state that the reference portfolio was "selected by" ACA Management LLC without disclosing the role of Paulson & Co. Inc. in the portfolio selection process and that Paulson's economic interests were adverse to CDO investors.

(*Id.* ¶ 87.)

On November 9, 2010, the Financial Industry Regulatory Authority ("FINRA") announced that it fined Goldman $650,000 for failing to disclose, within 30 days, that Tourre and Egol had received Wells Notices, in violation of National Association of Securities Dealers' ("NASD") Conduct Rule 3010 (which became FINRA Rule 2010, when FINRA succeeded NASD). (*Id.* ¶¶ 100-102.) In settling with

FINRA, Goldman admitted that it violated these rules. (*Id*. ¶¶ 101, 102.)

II. Hudson

Hudson was a synthetic CDO that commenced on or around December 5, 2006, which Goldman packaged and sold. (*Id*. ¶¶ 148, 164.) Plaintiffs allege that Goldman had "clear conflicts of interest" in the Hudson transaction because it knew that the reference assets were poor quality mortgage related securities which were likely to lose value, and yet, sold these products to its clients at higher prices than Goldman believed they were worth, while betting against those very securities, "thereby allowing the Company to reap billions in profits at their clients direct expense." (*Id*. ¶ 148.) Goldman had told investors that it "has aligned incentives with the Hudson program by investing in a portion of equity," without disclosing that it also held 100% of the short position at the same time. (*Id*. ¶¶ 165, 171, 177.) Goldman's incentive from holding $6 million in equity was substantially outweighed by its $2 billion short position. (*Id*. ¶ 171.) Further, Goldman had not disclosed that the assets had been taken directly from Goldman's inventory, and had been priced by Goldman's own personnel. (*Id*. ¶¶ 174, 177.)

III. Anderson

Anderson was a synthetic CDO transaction that closed on March 20, 2007, for which Goldman served as the sole credit protection buyer and acted as an intermediary between the CDO and various broker-dealers. (Compl. ¶¶ 190, 191, 202.) Goldman was the source of 28 of the 61 CDS contracts that made up Anderson, and held a 40% short position. (*Id*. ¶¶ 189-191.) Plaintiffs allege that Goldman developed misleading talking points for its sales force, which did not adequately disclose the asset selection process and touted that Goldman would hold up to 50% of the equity tranche in the CDO, which was worth $21 million, without mentioning its $135 million short position. (*Id*. ¶¶ 204-207).

IV. Timberwolf I

Timberwolf I is a hybrid CDO squared transaction,[2] which closed in March 2007, that Goldman constructed, underwrote, and sold. (*Id*. ¶ 213.) In its marketing booklet, Goldman stated that it was purchasing 50% of the equity tranche, but failed to disclose that it was the largest source of assets and held a 36% short position in the CDO. (*Id*. ¶¶ 214, 216.) Goldman aggressively sold Timberwolf I without explaining its pricing methodology. (*Id*. ¶ 255.) Plaintiffs allege that Goldman knew it was selling poorly quality assets at inflated prices, and profited from its short position. (*Id.* ¶¶ 264-67.)

LEGAL STANDARDS

Since Plaintiffs bring claims for security fraud, they must meet heightened pleading requirements of Fed. R. Civ. P. 9(b), and the Private Securities Litigation Reform Act of 1995 ("PSLRA"). *ATSI Commc'ns v. Shaar Fund, Ltd.*, 493 F.3d 87, 99 (2d Cir.2007); *see also* 15 U.S.C. § 78u–4(b)(1).

Section 10(b) of the Exchange Act prohibits any person from using or employing "any manipulative or deceptive device or contrivance in contravention" of SEC rules. 15 U.S.C. § 78j(b). Rule 10b-5, promulgated under Section 10(b), prohibits "any device, scheme, or artifice to defraud" and "any untrue statement of a

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[2] A CDO squared is backed by a pool of CDO tranches.

material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading . . . ." 17 C.F.R. § 240.10b-5.

To state a claim in a private action under section 10(b) and Rule 10b–5, a plaintiff must prove: "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission [or transaction causation]; (5) economic loss; and (6) loss causation." *Stoneridge Inv. Partners, L.L.C. v. Scientific–Atlanta, Inc.*, 552 U.S. 148, 157 (2008).

Defendants argue that the Complaint should be dismissed because: (1) Plaintiff failed to plead an actionable misstatement or omission; (2) Plaintiffs failed to allege facts giving rise to a strong inference of scienter; and (3) Plaintiffs failed to adequately allege loss causation.

<u>ANALYSIS</u>

I. Goldman's Failure to Disclose Its Receipt of Wells Notices

A. <u>Disclosure Requirements and The Wells Notice Process</u>

Under Section 13 of the Exchange Act, Regulation S-K Item 103, a company is required to "[d]escribe briefly any material pending legal proceedings . . . known to be contemplated by governmental authorities." 17 C.F.R. § 229.103. Section 240.12b-20 "supplements Regulation S–K by requiring a person who has provided such information in 'a statement or report . . . [to] add[ ] such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading.'" *United States v. Yeaman*, 987 F.Supp. 373, 381 (E.D.Pa. 1997).

The SEC provides a target of an investigation with a Wells Notice "whenever the Enforcement Division staff decides, even preliminarily, to recommend charges." *In re Initial Public Offering Sec. Litig.*, No. 21 MC 92(SAS), 2004 WL 60290, at *1 (S.D.N.Y. Jan. 12. 2004). The party at risk of an enforcement action is then entitled, under SEC rules, to make a "Wells submission" to the SEC, "presenting arguments why the Commissioners should reject the [Enforcement Division] staff's recommendation for enforcement." *WHX Corp. v. S.E.C.*, 362 F.3d 854, 860 (D.C. Cir. 2004) (citing 17 C.F.R. § 202.5(c)). A party's entitlement to make a Wells submission is "obviously based on recognition that staff advice is not authoritative." *Id.* Indeed, "[t]he Wells process was implemented so that the Commission would have the opportunity to hear a defendant's arguments before deciding whether to go forward with enforcement proceedings." *In re Initial Public Offering*, 2004 WL 60290, at *1. Accordingly, receipt of a Wells Notice does not necessarily indicate that charges will be filed.

"An investigation on its own is not a 'pending legal proceeding' until it reaches a stage when the agency or prosecutorial authority makes known that it is contemplating filing suit or bringing charges." *ABA Disclosure Obligations under the Federal Securities Laws in Government Investigations—Part II.C.*; *Regulation S-K*, *Item 103: Disclosure of "Legal Proceedings*," 64 Bus. Law. 973 (2009). A Wells Notice may be considered an indication that the staff of a government agency is considering making a recommendation, *id.*, but that is well short of litigation. Further, Plaintiffs conceded at oral argument that no court has ever held that a company's failure to disclose receipt of a Wells Notice constitutes an actionable omission under § 10(b) or Rule 10b-5. (May 21, 2012 Oral Arg. Tr. 22:17-22.)

In addition to Regulation S-K, Item 103, FINRA Rule 2010, and NASD Conduct Rule 3010 explicitly require financial firms to report an employee's receipt of a Wells Notice to FINRA within 30 days. (Compl. ¶ 100.)

In this case, the Defendants disclosed, as early as January 27, 2009, that there were governmental investigations into, *inter alia*, Goldman's synthetic CDO practices.[3] Goldman never disclosed the Wells Notices that it and its employees received on July 29, 2009, September 28, 2009, and January 29, 2010. (Compl. ¶¶ 90-94, 129.)

An omission is actionable where (1) the omitted fact is material; and (2) the omission is (a) "in contravention of an affirmative legal disclosure obligation"; or (b) needed "to prevent existing disclosures from being misleading." *In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d 347, 360 (2d Cir. 2010). Plaintiffs argue (1) that Defendants had to disclose their receipt of Wells Notices in order to

[3] Plaintiffs' Complaint cites to the 2009 10-K concerning "requests for information from various governmental agencies" regarding, *inter alia*, synthetic CDOs. (Compl. ¶ 129.) Both parties refer to this statement as notice of governmental "investigations." (*See e.g.*, Pl. Opp. 4.) Defendants attached SEC filings going back to at least January 27, 2009 that contain an identical disclosure. (*See* Walker Decl. Ex. J.) While these materials were not attached to the Complaint, the Court can take judicial notice of SEC filings. *See Finn v. Barney*, No. 11–1270–CV, 2012 WL 1003656, at *1 (2d Cir. Mar. 27, 2012).

prevent their prior disclosures about government investigations from being misleading, and (2) that Defendants had an affirmative legal obligation to disclose their receipt of Wells Notices under Regulation S-K, Item 103, FINRA and NASD Rules.

B. <u>A Duty to Be Accurate and Complete in Making Disclosures</u>

Plaintiffs' primary argument is that Defendants' disclosures about governmental investigations triggered a duty to disclose Goldman's subsequent receipt of Wells Notices. Specifically, Plaintiffs argue that by failing to disclose that the government inquiries resulted in Wells Notices, Defendants misled the public into "erroneously" concluding that "no significant developments had occurred which made the investigation more likely to result in formal charges." (Pl. Opp. 6.)

When a corporation chooses to speak—even where it lacks a duty to speak—it has a "duty to be both accurate and complete." *Caiola v. Citibank, N.A.*, 295 F.3d 312, 331 (2d Cir. 2002). A corporation, however, "only [has to reveal] such [facts], if any, that are needed so that what was revealed would not be so incomplete as to mislead." *In re Bristol Myers Squibb Co. Sec. Litig.*, 586 F.Supp.2d 148, 160 (S.D.N.Y. 2008) (citation omitted). The federal securities laws "do not require a company to accuse itself of wrongdoing." *In re Citigroup, Inc. Sec. Litig.*, 330 F.Supp.2d 367, 377 (S.D.N.Y. 2004) (citing *In re Am. Express Co. Shareholder Litig.*, 840 F.Supp. 260, 269-70 (S.D.N.Y. 1993)); *see also Ciresi v. Citicorp*, 782 F.Supp. 819, 823 (S.D.N.Y. 1991) (dismissing Exchange Act claims in part because "the law does not impose a duty to disclose uncharged, unadjudicated wrongdoing or mismanagement"). Moreover, "defendants [a]re not bound to predict as the 'imminent' or 'likely' outcome of the investigations that indictments of [the company] and its chief officer[s] would follow, with financial disaster in their train." *Ballan v. Wilfred Am. Educ. Corp.*, 720 F.Supp. 241, 248 (E.D.N.Y. 1989).

In *In re Citigroup*, plaintiffs' 10(b) claims premised on Citigroup's failure to disclose "litigation risks associated with its Enron-related, analysis/ investment banking and reporting activities" were dismissed because "Citigroup was not required to make disclosures predicting such litigation"; plaintiffs did not allege that litigation "was substantially certain to occur"; and the SEC filings at issue contained some "discuss[ion of] pending litigation." 330 F.Supp.2d at 377. Similarly, here, Plaintiffs do not allege that litigation was substantially certain to occur, and concede that Defendants provided some notice about ongoing governmental investigations in their SEC disclosures. Indeed, Plaintiffs cannot claim that a Wells Notice indicated that litigation was "substantially certain to occur" because Jonathan Egol, a Goldman employee, received a Wells Notice regarding the Abacus transaction and ultimately was not sued by the SEC. While Goldman and Tourre were sued, the Defendants were not obligated to predict and/or disclose their predictions regarding the likelihood of suit. *See Ballan*, 720 F.Supp. at 248.

Moreover, revealing one fact about a subject does not trigger a duty to reveal all facts on the subject, so long as "what was revealed would not be so incomplete as to mislead." *In re Bristol Myers*, 586 F.Supp.2d at 160 (quoting *Backman v. Polaroid Corp.*, 910 F.2d 10, 16 (1st Cir. 1990)). Plaintiffs have not shown that Defendants were required to disclose their receipt of Wells Notice to prevent their prior disclosures from being inaccurate or incomplete, as their receipt of Wells Notices indicated that the governmental investigations were indeed ongoing. While Plaintiffs claim to want to know about the Wells Notices, "a corporation is not required to disclose a fact merely because a reasonable investor would very much like to know that fact." *In re Time Warner Sec. Litig*, 9 F.3d 259, 267 (2d Cir. 1993). At best, a Wells Notice indicates not litigation but only the desire of the Enforcement staff to move forward, which it has no power to effectuate. This contingency need not be disclosed.

Plaintiffs also argue that Defendants' statements in response to a December 24, 2009 New York Times Article (the "Article") triggered a duty to disclose the Wells Notices. The Article, which mentioned other investment companies but focused on Goldman, stated that the SEC, Congress, and FINRA are scrutinizing "[h]ow these disastrously performing [synthetic CDO] securities were devised." (Walker Decl. Ex. O at 1.)[4] In response, Goldman released a one-page press release addressing answers to questions the Times had asked prior to publication, but which had not been included in the Article. Goldman explained how synthetic CDOs worked and why they were created. (Compl. ¶ 124.) Goldman's response did not address or mention the existence of governmental investigations. Accordingly, Goldman's press release contained nothing concerning the investigations that could be considered inaccurate or incomplete.

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[4] Since Plaintiffs obviously relied on this Article in drafting their Complaint, the Court can consider it here. *Roth v. Jennings*, 489 F.3d 499, 509 (2d Cir. 2007).

In sum, Plaintiffs have not shown that Defendants' nondisclosure of their receipt of Wells Notices made their prior disclosures about ongoing governmental investigations materially misleading; or that Defendants breached their duty to be accurate and complete in making their disclosures.

C. A Regulatory Duty To Disclose

Plaintiffs also argue that Defendants had an affirmative legal obligation to disclose their receipt of Wells Notices under Regulation S-K, Item 103, FINRA and NASD Rules. There is nothing in Regulation S-K, Item 103 which mandates disclosure of Wells Notices. Item 103 does not explicitly require disclosure of a Wells Notices, and no court has ever held that this regulation creates an implicit duty to disclose receipt of a Wells Notice. When the regulatory investigation matures to the point where litigation is apparent and substantially certain to occur, then 10(b) disclosure is mandated, as discussed above. Until then, disclosure is not required. Moreover, even if Goldman had such a duty here, "[i]t is far from certain that the requirement that there be a duty to disclose under Rule 10b–5 may be satisfied by importing the disclosure duties from [an] S–K [regulation]." *In re Canandaigua Sec. Litig.*, 944 F.Supp. 1202, 1210 (S.D.N.Y. 1996) (addressing S-K regulation 303).

With respect to FINRA Rule 2010 and NASD Conduct Rule 3010, there is no dispute that Goldman was bound by and violated these regulations by failing to disclose Tourre and Egol's receipt of Wells Notices within 30 days. (Compl. ¶¶ 100-103.) Courts, however, have cautioned against allowing securities fraud claims to be predicated solely on violations of NASD rules[5] because such "rules do not confer private rights of action." *Weinraub v. Glen Rauch Sec., Inc.*, 399 F.Supp.2d 454, 462 (S.D.N.Y. 2005); *Tucker v. Janney Montgomery Scott, Inc.*, No. 96 Civ. 1923(LLS), 1997 WL 151509, at *3 (S.D.N.Y. Apr. 1, 1997); *see also GMS Grp., LLC v. Benderson*, 326 F.3d 75, 81-82 (2d Cir. 2003) ("arguably there is no right of action simply for a violation of NASD rules.").[6]

Plaintiffs have not shown that Goldman had a regulatory duty, upon which a Section 10(b) or Rule 10b-5 claim can be based, to disclose its receipt of Wells Notices. Accordingly, Plaintiffs' claim premised on Defendants' failure to disclose receipt of Wells Notices fails.

D. Scienter

While there was no duty to disclose, even if there was such a duty, Plaintiffs' claim would still fail because Plaintiffs have not adequately alleged scienter.

"The requisite state of mind, or scienter, in an action under section 10(b) and Rule 10b-5 is 'an intent to deceive, manipulate or defraud.'" *In re GeoPharma, Inc. Sec. Litig.*, 411 F.Supp.2d 434, 441 (S.D.N.Y. 2006) (quoting *Ganino v. Citizens Utils. Corp.*, 228 F.3d 154, 168 (2d Cir.2000)). Moreover, to satisfy Rule 9(b), a plaintiff must allege "facts that give rise to a strong inference of fraudulent intent." *Shields v.*

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[5] This is applicable to FINRA rules, since FINRA is NASD's successor.

[6] A violation of Item 103 or NASD rules may nonetheless be relevant to a 10(b) and 10b-5 analysis. *See GMS Grp.*, 326 F.3d 75, 82 (NASD "violations may be considered relevant for purposes of § 10(b) unsuitability claims"); *Clark v. John Lamula Investors, Inc.*, 583 F.2d 594, 601 (2d Cir. 1978).

Citytrust Bancorp, *Inc*., 25 F.3d 1124, 1128 (2d Cir. 1994). A plaintiff claiming fraud can plead scienter "either (a) by alleging facts to show that defendants had both motive and opportunity to commit fraud, or (b) by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness." *Lerner v*. *Fleet Bank*, *N.A*., 459 F.3d 273, 290-91 (2d Cir. 2006).

While Plaintiffs failed to raise a strong inference of motive and opportunity,[7] "they could raise a strong inference of scienter under the 'strong circumstantial evidence [of conscious misbehavior or recklessness]' prong, 'though the strength of the circumstantial allegations must be correspondingly greater' if there is no motive." *ECA*, *Local 134 IBEW Joint Pension Trust of Chicago v*. *JP Morgan Chase Co*., 553 F.3d 187, 198-99 (2d Cir. 2009) (quoting *Kalnit v*. *Eichler*, 264 F.3d 131, 143-44 (2d Cir. 2001). Recklessness sufficient to establish scienter involves conduct that is "highly unreasonable and . . . represents an extreme departure

[7] Plaintiffs argue (in a footnote) that Defendants "had a motive to maintain [Goldman's] appearance of financial health . . . ." (Pl. Opp. 20-21 n.17 (quoting *RMED Intern*., *Inc*. *v*. *Sloan's Supermarkets*, *Inc*., 878 F.Supp. 16, 19 (S.D.N.Y. 1995).) In *RMED Intern*., the court found that Defendants had a motive to hide the existence of an FTC investigation in order to "maintain [Defendant's] appearance of financial health to both its existing shareholders and its potential investors." *Id*. This argument is made in Plaintiffs' opposition brief, but their Complaint does not allege that Defendants omitted any mention of Wells Notices in order to maintain the appearance of financial health. Even if Plaintiffs had made such an allegation, the Second Circuit has since held: "Motives that are common to most corporate officers, such as the desire for the corporation to appear profitable and the desire to keep stock prices high . . . do not constitute 'motive' for purposes of this inquiry." *ECA*, 553 F.3d at 198.

from the standards of ordinary care." *Chill v. Gen. Elec. Co.*, 101 F.3d 263, 269 (2d Cir.1996) (quoting *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 47 (2d Cir.1978)). A strong inference of scienter may arise where a plaintiff alleges, *inter alia*, defendants "'knew facts or had access to information suggesting that their public statements were not accurate'; or [ ] 'failed to check information they had a duty to monitor.'" *Novak v. Kasaks*, 216 F.3d 300, 311 (2d Cir. 2000).

Plaintiffs argue that Defendants knew of the Wells Notices and admitted that their failure to disclose Tourre and Egol's receipt of Wells Notices violated FINRA and NASD rules. As previously indicated, Defendants' failure to disclose receipt of Wells Notices did not make their prior and ongoing disclosures inaccurate. Thus, Defendants "failure to disclose [their receipt of Wells Notices], by itself, can only constitute recklessness if there was an obvious duty to disclose that information." *In re GeoPharma*, 411 F.Supp.2d at 446 (citing *Kalnit*, 264 F.3d at 143-44)). The requirement that the duty be "obvious" ensures that fraudulent intent will not be imputed to a company every time a public statement lacks detail. *See Bragger v. Trinity Capital Enter. Corp.*, No. 92 Civ. 2124 (LMM), 1994 WL 75239, at *4 (S.D.N.Y. Mar. 7, 1994).

Plaintiffs failed to show that Defendants had an obvious duty to disclose their receipt of Wells Notices. Regulation S-K, Item 103 and FINRA and NASD Rules do not create an obvious duty to disclose, sufficient for Section10(b) and Rule 10b-5 purposes; no court has ever held otherwise. Since "the duty to disclose . . . was not so clear," Defendants' "recklessness cannot be inferred from the failure to disclose." *Kalnit*, 264 F.3d at 143 (holding that since "this case does not present facts indicating a clear duty to disclose, plaintiff's scienter allegations do not provide *strong* evidence of conscious misbehavior or recklessness."); *see also In re GeoPharma*, 411 F.Supp.2d at 446-47 (holding that defendants had no "obvious duty to disclose [the contents of an] FDA letter" given "what defendants *did* disclose" in their press release).

In sum, Plaintiffs failed to satisfy both the duty and scienter requirements to state a Section 10(b) and Rule 10b-5 claim. Accordingly, Defendants' motion to dismiss Plaintiffs' claims premised on Defendants' failure to disclose their receipt of Wells Notices is GRANTED.

II. Goldman's Alleged Conflicts of Interest

Plaintiffs claim that Goldman made material misstatements and omissions concerning Goldman's business practices and conflicts of interest, which are actionable in light of Goldman's misstatements and fraudulent conduct in the Abacus, Hudson, Anderson, and Timberwolf I CDO transactions. Plaintiffs are Goldman's own shareholders—not investors in the Abacus, Hudson, Anderson, and Timberwolf I CDO transactions. Accordingly, to state a claim, Plaintiffs have to show that Goldman made material misstatements and omissions with the intent to defraud its own shareholders. *See In re Sadia, S.A. Sec. Litig.*, 643 F.Supp.2d 521, 532 (S.D.N.Y. 2009) (distinguishing acts that deceive a company's *own* shareholders, which can give rise to shareholders' securities fraud claims, from those that deceive investors in the securities of other companies, which are not actionable when raised by the company's own shareholders).

A. Actionable Misstatements and Omissions

Plaintiffs claim that Goldman's conduct in the Abacus, Hudson, Anderson, and Timberwolf I CDO transactions made the following disclosures materially misleading:

- "[W]e increasingly have to address potential conflicts of interest, including situations where our services to a particular client or our own proprietary investments or other interests conflict, or are perceived to conflict, with the interest of another client . . . ." (Compl. ¶ 134 (Form 10-K));
- "We have extensive procedures and controls that are designed to . . . address conflicts of interest" (Compl. ¶¶ 134, 154 (Form 10-K));
- "Our clients' interests always come first. Our experience shows that if we serve our clients well, our own success will follow." (Compl. ¶ 154 (Goldman Annual Report));
- "We are dedicated to complying fully with the letter and spirit of the laws, rules and ethical principles that govern us. Our continued success depends upon unswerving adherence to this standard." (Compl. ¶ 154 (Goldman Annual Report));
- "Integrity and honesty are at the heart of our business" (Compl. ¶ 289 (Goldman Annual Report));
- "Most importantly, and the basic reason for our success, is our extraordinary focus on our clients" (Compl. ¶ 154 (Viniar's

Statements on Goldman's Investor Conference Call));

- "Our reputation is one of our most important assets" (Compl. ¶ 154 (Form 10-K)).

Defendants argue that these statements are non-actionable statements of opinion, puffery, or mere allegations of corporate mismanagement (Def. Br. 20-21); and that Goldman's conflict of interest disclosures foreclose liability (Def. Reply Br. 8-10).[8]

"Expressions of puffery and corporate optimism do not give rise to securities violations." *Rombach v. Chang*, 355 F.3d 164, 174 (2d Cir. 2004) (citation omitted). "Likewise, allegations of corporate mismanagement without an element of deception or manipulation are not actionable." *Lapin v. Goldman Sachs Grp., Inc.*, 506 F.Supp.2d 221, 239 (S.D.N.Y. 2006) (citing *In re Citigroup, Inc. Sec. Litig.*, 330 F. Supp.2d 36, 375-76 (S.D.N.Y. 2004)). "The important limitation on these principles is that optimistic statements may be actionable upon a showing that the defendants did not genuinely or reasonably believe the positive opinions they touted (i.e., the opinion was without a basis in fact or the speakers were aware of facts undermining the positive statements), or that the opinions imply certainty." *Id.* (citing cases). Moreover, by putting the "topic of the cause of its financial success at issue, [a company] then [ ] is

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[8] Goldman's arguments in this respect are Orwellian. Words such as "honesty," "integrity," and "fair dealing" apparently do not mean what they say; they do not set standards; they are mere shibboleths. If Goldman's claim of "honesty" and "integrity" are simply puffery, the world of finance may be in more trouble than we recognize.

'obligated to disclose information concerning the source of its success, since reasonable investors would find that such information would significantly alter the mix of available information." *In re Van der Moolen Holding N.V. Sec. Litig.*, 405 F.Supp.2d 388, 400-01 (S.D.N.Y. 2005) (quoting *In re Providian Fin. Corp. Sec. Litig.*, 152 F.Supp.2d 814, 824-25 (E.D.Pa. 2001).

Additionally, disclaimers do not always shield a defendant from liability. For example, "[c]autionary words about future risk cannot insulate from liability the failure to disclose that the risk has transpired." *Rombach*, 355 F.3d at 173. Indeed, "under certain circumstances, cautionary statements can give rise to Section 10(b) liability." *In re Van der Moolen*, 405 F.Supp.2d at 400. "[T]he disclosure required by the securities laws is measured not by literal truth, but by the ability of the material to accurately inform rather than mislead prospective buyers." *McMahan v. Wherehouse Entm't, Inc.*, 900 F.2d 576, 579 (2d Cir. 1990).

With respect to the Abacus transaction, Plaintiffs argue that Goldman's conduct "involved both client conflicts and outright fraud." (Pl. Opp. 15). Plaintiffs allege that Goldman knowingly allowed Paulson to select the assets for the Abacus CDO, and knew that Paulson was selecting assets that it believed would perform poorly or fail. (*See*, *e.g.*, Compl. ¶¶ 59-66.) To compound this absence of transparency, Goldman hid Paulson's role, and disclosed only ACA's role in the asset selection process, in order to "leverage ACA's credibility and franchise to help distribute this Transaction." (*Id.*) Plaintiffs have thus plausibly alleged that Goldman made a material omission regarding Paulson's role in the asset selection process when it spoke about this topic. *See Caiola v. Citibank, N.A.*, 295 F.3d 312, 331 (2d Cir. 2002) (holding that corporations have a "duty to be both accurate and complete" in their disclosures). Investors on the long side of this offering, the ratings agencies, and ACA were kept in the dark.

Goldman's assertion that it "neither admitted, nor denied" that its Abacus disclosures were fraudulent is eviscerated by its concession that "it was a mistake for the Goldman marketing materials to state that the reference portfolio was 'selected by' ACA Management LLC without disclosing the role of Paulson & Co. Inc. in the portfolio selection process and that Paulson's economic interests were adverse to CDO investors." (*Id.* ¶ 144.) Goldman paid a $550 Million settlement to the SEC—the largest SEC penalty in history—because of the "mistake" it acknowledged. (*Id.*) In the SEC action, District Court Judge Barbara S. Jones found Tourre's conduct fraudulent because: "having allegedly affirmatively represented Paulson had a particular investment interest in ABACUS—that it was long—in order to be both accurate and complete, Goldman and Tourre had a duty to disclose Paulson had a different investment interest—that it was short . . . [because it was] a fact that, if disclosed, would significantly alter the 'total mix' of available information." *S.E.C. v. Goldman Sachs & Co.*, 790 F.Supp.2d 147, 162-63 (S.D.N.Y. 2011) (internal citations and quotations omitted).

In the Hudson, Anderson, and Timberwolf I CDO transactions Goldman affirmatively represented that it held a long position in the equity tranches, without disclosing its substantial short positions. Specifically, in the Hudson transaction, Goldman stated that it had "aligned incentives" with investors by "investing in a portion of equity," which amounted to $6 Million, without disclosing that it also held 100% of the short position at the same time, which amounted to $2 Billion. (Compl. ¶¶ 148, 164, 165, 171, 174, 177.)[9] Goldman's talking points in the Anderson transaction touted that Goldman would hold up to 50% of the equity tranche, which would be worth up to $21 Million, without mentioning its $135 Million short position. (*Id.* ¶¶ 204-207). Goldman's marketing booklet for the Timberwolf I transaction stated that Goldman was purchasing 50% of the equity tranche, without disclosing that it was the largest source of assets and held a 36% short position in the CDO. (*Id.* ¶¶ 214, 216.) Thus, as with the Abacus transaction, Plaintiffs have plausibly alleged that Goldman made material omissions in the Hudson, Anderson, and Timberwolf I transactions because "having allegedly affirmatively represented [Goldman] had a particular investment interest in [these synthetic CDOs]—that it was long—in order to be both accurate and complete, Goldman . . . had a duty to disclose [it] had a [greater] investment interest [from its] short [position]. . . .

[9] Goldman's statements in the Hudson transaction were made before the beginning of the class period. (Compl. ¶¶ 148, 164, 165, 171, 174, 177.) While a defendant can be found "liable only for those statements made during the class period," *In re IBM Sec. Litig.*, 163 F.3d 102, 107 (2d Cir. 1998), a prior misstatement does not require dismissal, if the prior statement is "relevant in determining whether defendants had a duty to make a corrective disclosure during the Class Period." *In Re Quintel Entm't Sec. Litig.*, 72 F. Supp. 2d 283, 290-291 (S.D.N.Y. 1999). Here, it was Goldman's subsequent statements regarding its business practices and conflicts of interest, which were made during the relevant time period, that are alleged to be material misstatements when viewed in light of Goldman's previous conduct in the Hudson transaction. Accordingly, the Court need not dismiss such conduct.

[because that was] a fact that, if disclosed, would significantly alter the 'total mix' of available information." *S.E.C. v. Goldman Sachs & Co.*, 790 F.Supp.2d at 162-163.

Plaintiffs plausibly allege that Goldman's material omissions in the Abacus, Hudson, Anderson, and Timberwolf I transactions: (1) made its disclosures, to its own shareholders, concerning its business practices materially misleading; and (2) conflicted with its shareholders' interests, because fraudulent conduct hurts a company's share price, and concealing such conduct caused Goldman's stock to trade at artificially high prices, as discussed below. Given Goldman's fraudulent acts, it could not have genuinely believed that its statements about complying with the letter and spirit of the law—and that its continued success depends upon it, valuing its reputation, and its ability to address "potential" conflict of interests were accurate and complete. *See Lapin*, 506 F.Supp.2d at 240 (upholding securities law claims where the complaint "alleges that Goldman knew about the pervasive conflicts and the effect they had on its research reports and buy recommendations, allegedly one of its core competencies, yet, they allegedly failed to disclose such material information to its investors."); *see also In re Sadia, S.A. Sec. Litig.*, 643 F.Supp.2d at 532 (upholding securities law claims where plaintiffs alleged that defendants materially misstated in their Sarbanes-Oxley certifications that there was not "any fraud" at the company, while "knowingly conceal[ing] that the Company had entered into substantial high-risk currency hedging contracts in violation of its internal hedging policy.")

Goldman must not be allowed to pass off its repeated assertions that it complies with the letter and spirit of the law, values its reputation, and is able to address "potential" conflicts of interest as mere puffery or statements of opinion. Assuming the truth of Plaintiffs' allegations, they involve "misrepresentations of existing facts." *Freudenberg v. E*Trade Financial Corp.*, 712 F.Supp.2d 171, 190 (S.D.N.Y. 2010) (finding "statements touting risk management [that] were . . . juxtaposed against detailed factual descriptions of the Company's woefully inadequate or non-existent credit risk procedures" were actionable misstatements) (quoting *Novak*, 216 F.3d at 315). Moreover, Goldman's allegedly manipulative, deceitful, and fraudulent conduct in hiding Paulson's role and investment position in Abacus transaction, and in hiding its own investment position in Hudson, Anderson, and Timberwolf I transactions takes Plaintiffs' claim beyond that of mere mismanagement. *See Lapin*, 506 F.Supp.2d at 240 ("Goldman also misconstrues Plaintiff's allegations as merely stating it mismanaged its research business by allowing conflicts to proliferate[,] . . . . [when the complaint] actually alleges that Goldman knew about the pervasive conflicts and the effect they had on its research reports and buy recommendations, allegedly one of its core competencies, yet, they allegedly failed to disclose such material information to its investors."); *see also Freudenberg*, 712 F.Supp.2d at 193 ("Because Plaintiffs allege that Defendants intentionally misled the public, rather than simply making bad business decisions, Plaintiffs have pled more than mere mismanagement.").

Defendants also argue that the above statements were not material. A complaint, however, "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 investor that reasonable minds could not differ on the question of their importance." *ECA*, 553 F.3d at 197 (quoting *Ganino*, 228 F.3d at 162). Plaintiffs have sufficiently alleged that Goldman's misstatements in the Abacus, Hudson, Anderson, and Timberwolf I transactions were material. *See S.E.C. v. Goldman Sachs*, 790 F.Supp.2d at 162-63 (finding that Paulson's role was "a fact that, if disclosed, would significantly alter the 'total mix' of available information."). Accepting Plaintiffs allegations as true at this juncture, as the Court must, the Court cannot say that Goldman's statements that it complies with the letter and spirit of the law and that its success depends on such compliance, its ability to address "potential" conflict of interests, and valuing its reputation, would be so obviously unimportant to a reasonable investor. *See generally*, *Lapin*, 506 F.Supp.2d at 240-41 ("[I]t defies logic to suggest that, for example, an investor would not reasonably rely on a statement, contained in . . . a list of Goldman's business principles, that recognized Goldman's dedication to complying with the letter and spirit of the laws and that Goldman's success depended on such adherence."); *In re Citigroup Inc. Sec. Litig.*, 753 F.Supp.2d 206, 236 (S.D.N.Y. 2010).

Accordingly, Plaintiffs have sufficiently alleged that Goldman made material misstatements about its business practices and conflicts of interest, viewed in light of its role and conduct in the Abacus, Hudson, Anderson and Timberwolf I transactions.

B. Scienter

A strong inference of scienter can arise where defendants "knew facts or had access to information suggesting that their public statements were not accurate." *Novak*, 216 F.3d at 311.

With respect to Abacus, Goldman certainly knew that Paulson played an active role in the asset selection process. How else could Goldman admit that it was a "mistake" not to have disclosed such information. Goldman knew that Paulson's interests were adverse to investors as "Paulson had agreed to pay Goldman a higher fee if Goldman could provide Paulson with CDS contracts containing premium payments below a certain level." (*Id.* ¶ 77.) Goldman approached and enlisted ACA without disclosing Paulson's intended role as the sole short party. (*Id.* ¶ 61.) Goldman "expressed hope that ACA's involvement would improve sales" and "expect[ed] to leverage ACA's credibility and franchise to help distribute this transaction." (*Id.*) Rather than disclose Paulson's role or adverse interests, however, Goldman concealed its actions and put forward ACA as the sole asset selector. (*Id.* ¶ 66.) Plaintiffs have thus plausibly created a strong inference of scienter with respect to Goldman's knowledge of its material misstatements and omissions in the Abacus transaction. *See S.E.C. v. Goldman Sachs & Co.*, 790 F.Supp.2d at 163.

With respect to the Hudson, Anderson, and Timberwolf I CDOs, Plaintiffs have plausibly alleged that Goldman knew that its statements about holding long positions and having aligned interest with investors were inaccurate due to its substantial short positions. Indeed, Plaintiffs have referenced a number of internal Goldman communications showing that Goldman believed that the "[s]ubprime environment" was "bad and getting worse," and wanted to make a "structured exit" by "trying to close everything down, but stay on the short side."[10] (Compl. ¶¶ 195, 202.) Goldman concealed its efforts to shut "everything down" and "stay on the short side" in the Hudson, Anderson, and Timberwolf I CDOs by claiming to have aligned interest with investors and disclosing only its long position.

Meanwhile, Goldman repeatedly reassured its own shareholders that it was complying with the letter and spirit of the law and that its "continued success depends upon unswerving adherence to this standard"; and that it had procedures in place to address "potential conflicts of interest." (Compl. ¶¶ 134, 154). Given Goldman's practice of making material misrepresentations to third party investors regarding its short position, or Paulson's short position, Goldman knew or should have known that its statements about complying with the letter and spirit of the law, and its disclaimers regarding "potential" conflicts of interest were inaccurate and incomplete. *See Lapin*, 506 F.Supp.2d at 241-42; *In re Citigroup Inc. Sec. Litig.*, 753 F.Supp.2d 206, 238 (S.D.N.Y. 2010) (finding Plaintiffs adequately alleged scienter by

[10] "When the defendant is a corporate entity, the law imputes the state of mind of the employees or agents who made the statement(s) to the corporation." *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 543 (S.D.N.Y. 2011) (citing *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc.*, 531 F.3d 190, 195 (2d Cir. 2008) ("To prove liability against a corporation, of course, a plaintiff must prove that an agent of the corporation committed a culpable act with the requisite scienter, and that the act (and accompanying mental state) are attributable to the corporation.")). Accordingly, the scienter reflected in Goldman's Mortgage Department Head's statements can be attributed to Goldman.

showing that "Citigroup was taking significant steps internally to address increasing risk in its CDO portfolio but at the same time it was continuing to mislead investors about the significant risk those assets posed."). Accepting Plaintiffs allegations as true, there is a strong inference of scienter with respect to Goldman's conduct in the Hudson, Anderson and Timberwolf I transactions.

C. Loss Causation

Allegations of loss causation are not subject to the heightened pleading requirements of Rule 9(b) and the PSLRA. Rather, a "short and plain statement"—the standard of Rule 8(a)—"is all that is necessary at this stage of the litigation." *CompuDyne Corp. v. Shane*, 453 F.Supp.2d 807, 828 (S.D.N.Y. 2006).

To survive a motion to dismiss, a plaintiff need only allege either: "(i) facts sufficient to support an inference that it was a defendant's fraud — rather than other salient factors—that proximately caused plaintiff's loss," *Lentell v. Merrill Lynch & Co., Inc*, 396 F.3d 161, 177 (2d Cir. 2005), or (ii) "facts that would allow a factfinder to ascribe some rough proportion of the whole loss to . . . [the defendant's fraud]." *Lattanzio v. Deloitte & Touche LLP*, 476 F.3d 147, 158 (2d Cir. 2007). "[L]oss causation has to do with the relationship between the plaintiff's investment loss and the information misstated or concealed by the defendant. If that relationship is sufficiently direct, loss causation is established, but if the connection is attenuated, or if the plaintiff fails to demonstrate a causal connection between the content of the alleged misstatements or omissions and the harm actually suffered, a fraud claim will not lie." *Lentell*, 396 F.3d at 174 (quotations and citations omitted).

A decline in stock price following a public announcement of “bad news” does not, by itself, demonstrate loss causation. *See Leykin v. AT & T Corp.*, 423 F.Supp.2d 229, 245 (S.D.N.Y. 2006). A plaintiff may, however, “successfully allege loss causation by . . . alleging that the market reacted negatively to a ‘corrective disclosure,’ which revealed an alleged misstatement’s falsity or disclosed that allegedly material information had been omitted.” *In re Merrill Lynch & Co. Research Reports & Sec. Litig.*, No. 02 Civ. 9690(JFK), 2008 WL 2324111, at *5 (S.D.N.Y. June 4, 2008). “[A] corrective disclosure need not take the form of a single announcement, but rather, can occur through a series of disclosing events.” *In re Bristol Myers Squibb Co. Sec. Litig.*, 586 F.Supp.2d 148, 165 (S.D.N.Y. 2008) (citing cases).

Plaintiffs claim to have purchased Goldman stock at inflated values because they purchased stock before Goldman’s practice of making material misstatements and omissions came to light. (Compl. ¶ 329.) They claim that Goldman’s misstatements and conflicts of interest came to light on: (1) April 16, 2010, when the SEC filed fraud charges related to the Abacus transaction, which caused Goldman’s stock to drop from $184.27 per share to $160.70 per share (a 13% drop); (2) April 25-26, 2010, when the Senate released Goldman’s internal emails reflecting its practice of betting against the securities it sold to investors, which caused a stock drop from $157.40 per share to $152.03 per share (a 3% drop); and (3) June 10, 2010, when the SEC announced it was investigating the Hudson CDO transaction, which caused a stock drop from $136.80 per share to $133.77 per share (a 2% drop). (Compl. ¶¶ 329-35.)

While Defendants argue that the lawsuits and investigations themselves cause the stock decline, these suits and investigations can more appropriately be seen as a series of "corrective disclosures," because they revealed Goldman's material misstatements—and indeed pattern of making misstatements—and its conflicts of interest. *See In re Bristol Myers*, 586 F.Supp.2d at 164 (finding that a "disclosure of the Justice Department investigation" was "more akin to a corrective disclosure" because it revealed that Defendants had not complied with their obligation to present accurate information to regulators which resulted in the investigation). Plaintiffs' allegations are thus sufficient at this juncture to show that Goldman's misstatements and omissions caused, or at least contributed to, Plaintiffs' losses. *See id*. at 164-66; *see also Emergent Capital Inv. Mgmt., LLC v. Stonepath Grp., Inc.*, 343 F.3d 189, 197 (2d Cir. 2003) (viewing the facts most favorably to plaintiff and finding allegations that defendants artificially inflated the stock before "dumping" their own was adequate to allege loss causation).

III. Individual Defendants

For the Individual Defendants "to be liable for securities fraud, these defendants must also be responsible for [Goldman's] misleading statements and omissions." *In re Citigroup Inc. Sec. Litig.*, 753 F.Supp.2d 206, 239 (S.D.N.Y. 2010). Each of the Individual Defendants is alleged to have helped prepare the SEC filings at issue. (Compl. ¶ 38-40, 154.)

To show scienter, Plaintiffs allege that each of the Individual Defendants had knowledge of Goldman's synthetic CDO operations. Specifically, Plaintiffs allege that in February 2007—before the Abacus, Anderson, and Timberwolf I CDOs closed, Blankfein reviewed the Mortgage Department's efforts to reduce its subprime RMBS positions and asked about: "losses stemming from residual positions in old deals. Could/should we have cleaned up these books before and are we doing enough right now to sell off cats and dogs in other books throughout the division." (Compl. ¶ 194.) Viniar and Cohn were the recipients of the email from Goldman's Mortgage Department Head stating that Goldman was trying to make a "structured exit" from the subprime market by "trying to close everything down, but stay on the short side." (Compl. ¶ 202.) Cohn and Viniar were alerted to Hudson's sales efforts, and how the CDO assets were valued. (Compl. ¶ 181.) Viniar was also alerted to how the CDOs were valued in general, Goldman's sales efforts with respect to CDOs, and even chaired multiple meetings on the CDO transactions at issue. (Compl. ¶¶ 181, 233.) "Although plaintiffs do not allege with specificity the matters discussed at these meetings, their mere existence is indicative of scienter: That defendants engaged in meetings concerning [Goldman's] CDO risks is inconsistent with the company's public statements" that they held equity positions and had interests that were aligned with the purchasers of the synthetic CDOs. *In re Citigroup*, 753 F.Supp.2d at 238-239 (S.D.N.Y. 2010).

These allegations, taken as true, show that each Individual Defendant actively monitored the status of Goldman's subprime assets and subprime deals during the relevant time, and that each knew that Goldman was trying to purge these assets from its books and stay on the short side. These allegations create a strong inference that the Individual Defendants knew that Goldman was making material misstatements in the Abacus, Hudson, Anderson, and

Timberwolf I CDOs, when it sold poor quality assets to investors without disclosing its or Paulson's substantial short positions. Given such knowledge, the Individual Defendants were in a position to know that Goldman's statements about complying with the letter and spirit of the law, valuing its reputation, and disclaimers regarding "potential" conflicts of interest were inaccurate and incomplete.

IV. Section 20 Claims

To maintain a claim for control person liability pursuant to Section 20(a), a plaintiff must "allege facts showing (1) 'a primary violation by the controlled person,' (2) 'control of the primary violator by the targeted defendant,' and (3) that the 'controlling person was in some meaningful sense a culpable participant in the fraud perpetrated.'" *In re Citigroup*, 753 F.Supp.2d at 248 (quoting *In re Beacon Assocs. Litig.*, 745 F.Supp.2d at 411, 2010 WL 3895582, at *17).

The Individual Defendants do not contest their control person status; rather they argue that Plaintiffs have not alleged a primary violation by a controlled person. For the reasons above, however, Plaintiffs have plausibly alleged § 10(b) and 10b-5 claims against Goldman. Moreover, for the reasons above, Plaintiffs have adequately alleged culpable participation with respect to the Individual Defendants, because "[a]llegations sufficient to plead scienter for the purposes of primary liability pursuant to Section 10(b) 'necessarily satisfy' the culpable participation pleading requirement for Section 20(a) claims." *Id*. Accordingly, Defendants' motion to dismiss Count Two is denied.

CONCLUSION

In conclusion, Defendants' motion to dismiss is GRANTED with respect to Plaintiffs' claim relating to Defendants' failure to disclose their receipt of Wells Notices, and DENIED in all other respects. The Clerk of Court is directed to terminate this motion.

Dated: New York, New York
June 21, 2012

SO ORDERED,

/s/ Paul A. Crotty
PAUL A. CROTTY
United States District Judge

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

Master File No. 10 Civ. 3461 (PAC)

IN RE GOLDMAN SACHS GROUP, INC.
SECURITIES LITIGATION

This Document Relates To: ALL ACTIONS

MEMORANDUM & ORDER

HONORABLE PAUL A. CROTTY, United States District Judge:

In this consolidated securities class action, Plaintiffs allege that Goldman Sachs Group, Inc. ("Goldman") and certain of its senior executives (collectively, "Defendants") made material misstatements and misleading omissions relating to four collateralized debt obligation ("CDO") transactions in 2006 and 2007. Previously, the Court (1) granted Defendants' motion to dismiss claims regarding their failure to disclose Goldman's receipt of Wells notices from the Securities and Exchange Commission ("SEC"), but (2) denied the motion with respect to claims that Goldman had made misstatements about its conflicts of interest in those transactions. *See Richman v. Goldman Sachs Grp., Inc.*, 868 F. Supp. 2d 261 (S.D.N.Y. 2012). Defendants now move for partial reconsideration of that decision on the grounds that three intervening Second Circuit decisions have clarified what kinds of statements constitute inactionable "puffery." The motion is denied.

BACKGROUND

A. The Court's Prior Decision

As explained more fully in the Court's prior decision, Plaintiffs allege that Goldman improperly failed to disclose that it, or a favored client, held short positions in certain CDO transactions that it sold to other clients. *See id.* 269–71. That is, Goldman allegedly had conflicts of interests with those buyer-clients because it was selling them the same financial products that it was effectively betting against and profiting from the clients' losses. *See id.* In three of those transactions, "Goldman affirmatively represented that it held a long position in the equity tranches, without disclosing its substantial short positions." *Id.* at 278. In one of those three, "Goldman stated that it had 'aligned incentives' with investors by 'investing in a portion of equity,' which amounted to $6 Million, without disclosing that it also held 100% of the short position at the same time, which amounted to $2 Billion." *Id.* at 278–79.

In light of the foregoing conduct, Plaintiffs claim that the following statements made by Defendants during the class period were materially misleading:

- "[W]e increasingly have to address potential conflicts of interest, including situations where our services to a particular client or our own proprietary investments or other interests conflict, or are perceived to conflict, with the interest of another client . . . ." (Compl. ¶ 134 (Form 10–K))
- "We have extensive procedures and controls that are designed to . . . address conflicts of interest." (Compl. ¶¶ 134, 154 (Form 10–K))

- "Our clients' interests always come first. Our experience shows that if we serve our clients well, our own success will follow." (Compl. ¶ 154 (Goldman Annual Report))
- "We are dedicated to complying fully with the letter and spirit of the laws, rules and ethical principles that govern us. Our continued success depends upon unswerving adherence to this standard." (Compl. ¶ 154 (Goldman Annual Report))
- "Integrity and honesty are at the heart of our business." (Compl. ¶ 289 (Goldman Annual Report))
- "Most importantly, and the basic reason for our success, is our extraordinary focus on our clients." (Compl. ¶ 154 (Viniar's Statements on Goldman's Investor Conference Call))
- "Our reputation is one of our most important assets." (Compl. ¶ 154 (Form 10–K))

See 868 F. Supp. 2d at 277.

Both parties previously addressed *ECA & Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187, 206 (2d Cir. 2009) ("*JP Morgan*"), which held that the statements at issue were "no more than 'puffery'" because they were "too general to cause a reasonable investor to rely upon them." The defendant's statements at issue there were that it "had 'risk management processes [that] are highly disciplined and designed to preserve the integrity of the risk management process,' that it 'set the standard' for 'integrity,' and that it would 'continue to reposition and strengthen [its] franchises with a focus on financial discipline.'" *Id.* at 205–06 (citations omitted). The plaintiffs argued that those statements "were misleading because [defendant]'s poor financial discipline led to liability in the WorldCom litigation and involvement in the Enron scandal." *Id.* at 206. The Second Circuit rejected the argument, reasoning that they "were merely generalizations regarding [defendant]'s business practices" and did not "amount to a guarantee that its choices would prevent failures in its risk management practices." *Id.*

In this case, the Court rejected Defendants' argument that *JP Morgan* required dismissal: "[T]he Court cannot say that Goldman's statements that it complies with the letter and spirit of the law and that its success depends on such compliance, its ability to address 'potential' conflict of interests, and valuing its reputation, would be so obviously unimportant to a reasonable investor." 868 F. Supp. 2d at 280.

B. Intervening Second Circuit Decisions

Defendants cite three subsequent Second Circuit decisions which held that certain general statements about compliance, reputation, and integrity were inactionable puffery. *See City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG*, No. 12-4355-CV, 2014 WL 1778041, at *5, 6 (2d Cir. May 6, 2014) ("*UBS*"); *Carpenters Pension Trust Fund of St. Louis v. Barclays PLC*, No. 13-2678-CV, 2014 U.S. App. LEXIS 7864, at *22–23 (2d Cir. Apr. 25, 2014) ("*Barclays*"); *Boca Raton Firefighters & Police Pension Fund v. Bahash*, 506 F. App'x 32, 37 (2d Cir. 2012) (summary order) ("*Bahash*"). Defendants contend that if applied here, these cases would result in dismissal of the pending claims.

In *UBS*, the defendant stated that it "held its employees to the highest ethical standards and complied with all applicable laws, and that [its] wealth management division did not provide services to clients in the United States when, in fact, [it] was [allegedly] engaged in [a] cross-border tax scheme." 2014 WL 1778041, at *4. The Second Circuit affirmed dismissal of the plaintiffs' claim that the statements were misleading:

> It is well-established that general statements about reputation, integrity, and compliance with ethical norms are inactionable "puffery" . . . . This is particularly true where, as here, the statements are explicitly aspirational, with qualifiers such as "aims to," "wants to," and "should." Plaintiffs' claim that these statements were knowingly and verifiably false when made does not cure their generality, which is what prevents them from rising to the level of materiality required to form the basis for assessing a potential investment.

Id. at *5 (citing *JP Morgan*, 553 F.3d at 206). The court also affirmed dismissal of a claim that defendant had falsely stated that it "avoided 'concentrated positions' of assets," though it had accumulated a portfolio of $100 billion in residential mortgage-backed securities ("RMBS") and related CDOs. *Id.* at *6–7. The court observed that the plaintiffs' contention that this statement was an "important" representation missed the mark: "[W]hile importance is undoubtedly a *necessary* element of materiality, importance and materiality are not synonymous. To be 'material' within the meaning of § 10(b), the alleged misstatement must be sufficiently specific for an investor to reasonably rely on that statement as a guarantee of some concrete fact or outcome . . . ." *Id.* at *6 (citing, *inter alia*, *JP Morgan*, 553 F.3d at 206). The court further explained that the statements at issue were "too open-ended and subjective to constitute a guarantee that UBS would not accumulate a $100 billion RMBS portfolio, comprising 5% of UBS's overall portfolio, or 16% of its trading portfolio." *Id.* at *7.

In *Barclays*, the defendant stated that "[m]inimum control requirements have been established for all key areas of identified risk," even though it allegedly "submit[ted] false information for the purpose of calculating the London Interbank Offered Rate ("LIBOR")" and "had no specific systems or controls for its LIBOR submissions process." 2014 U.S. App. LEXIS 7864, at *3, 9. The Second Circuit affirmed dismissal on the grounds that the plaintiffs did not "demonstrate with specificity that Barclays's minimum control statements were false or misleading" as required by the Private Securities Litigation Reform Act ("PSLRA"), 15 U.S.C. § 78u-4(b)(1)(B). *Id.* at *22–23. The court explained that "Barclays's statements do not mention LIBOR, nor do they say that Barclays had established 'specific systems or controls' relating to LIBOR submission rates. . . . [,] but only that it had established controls for other areas of its business." *Id.* at *22.

In *Bahash*, the Second Circuit affirmed dismissal of claims that defendants "made public statements about the honesty and integrity of S&P's credit-ratings services while knowing that its ratings method was basically a sham." 506 F. App'x at 34. The court stated that these statements "are the type of mere 'puffery' that we have previously held to be not actionable" due to their "generic, indefinite nature." *Id.* at 37.

DISCUSSION

I. Standard for Motion for Reconsideration

A district court's discretion to reconsider a prior decision is "limited" by the doctrine of the law of the case: "where litigants have once battled for the court's decision, they should neither be required, nor without good reason permitted, to battle for it again." *Official Comm. of Unsecured Creditors of Color Tile, Inc. v. Coopers & Lybrand, L.L.P.*, 322 F.3d 147, 167 (2d Cir. 2003) (internal quotation marks omitted). Accordingly, decisions should "not usually be changed unless there is 'an intervening change of controlling law, the availability of new evidence, or the need to correct a clear error or prevent a manifest injustice.'" *Id.*

"It is not enough . . . that defendants could now make a more persuasive argument . . . . The law of the case will be disregarded only when the court has 'a clear conviction of error' with respect to a point of law on which its previous decision was predicated." *Fogel v. Chestnutt*, 668 F.2d 100, 109 (2d Cir. 1981) (citation omitted). "Thus generally, there is a strong presumption against amendment of prior orders." *Bergerson v. N.Y. State Office of Mental Health*, 652 F.3d 277, 288 (2d Cir. 2011).

II. Analysis

A. Basis for Reconsideration

Contrary to Defendants' argument, *UBS*, *Barclays*, and *Bahash* do not constitute an intervening change in controlling law, but merely elaborate on *JP Morgan*, which the Court considered in its June 2012 decision.

Defendants principally rely on *UBS*, where the Second Circuit stated that the "puffery" rule it was applying was "well-established" liberally quoted the portion of *JP Morgan* that was at issue in the motion to dismiss. *See* 2014 WL 1778041, at *5 & nn.43, 44. Likewise, *UBS*'s subsequent observations—regarding the "guarantee" element of materiality and the distinction between "importance" and materiality—cited substantially identical statements in *JP Morgan*. *See id.* at *6 & nn.56, 57.

Nor do *Barclays* or *Bahash* constitute a *sub silentio* change in controlling law. *Barclays* did not announce any new rule regarding materiality; rather, it contains a brief discussion applying the PSLRA's heightened pleading standard to the issue of whether particular statements were false or misleading under the circumstances. *See* 2014 U.S. App. LEXIS 7864, at *22–23 ("Plaintiffs fail, therefore, to demonstrate with specificity that Barclays's minimum control statements were false or misleading."). *Bahash* was a nonprecedential summary order[1] concluding that the statements at issue "regarding [defendant]'s integrity and credibility and the objectivity of S&P's credit ratings are the type of mere 'puffery' that we have ***previously held*** to be not actionable." 506 F. App'x at 37 (emphasis added) (citing *JP Morgan*, 553 F.3d at 206).

Defendants apparently seek an exception to the requirement that there be a change in controlling law, suggesting that a decision that "clarif[ies]" or "extend[s] and crystallize[s] the scope and meaning" of a prior decision is sufficient to warrant reconsideration. (Defs.' Mem. at 4, 8.) Of course, the law changes, but reconsideration is not warranted

[1] *See* 2d Cir. Local R. 32.1.1(a) ("Rulings by summary order do not have precedential effect.").

when an appellate court "merely applie[s] the existing standard to a new set of facts." *In re Fannie Mae 2008 ERISA Litig.*, No. 09-CV-1350, 2014 WL 1577769, at *4 (S.D.N.Y. Apr. 21, 2014). Accordingly, the motion for reconsideration must be denied.

B. There Was No Error in the Prior Decision

Even if the Court were to grant the motion for reconsideration, it would adhere to its prior decision. As Judge Scheindlin noted in distinguishing *Barclays* and *Bahash* from this case, Goldman's "statements about business practices were directly related to the subject of the fraud." *Gusinsky v. Barclays PLC*, 944 F. Supp. 2d 279, 290 n.74 (S.D.N.Y. 2013), *aff'd in relevant part*, *Barclays*, 750 F.3d 227.

The statements at issue in *UBS*, *Barclays*, and *Bahash* were too open-ended, indefinite, or subjective to be actionable under the circumstances. For instance, in *UBS*, the defendant's statement that it strove to comply with applicable laws could not be interpreted as a guarantee that it would never be out of compliance, and its statement that it avoided "concentrated positions of assets" was not a guarantee that it would avoid investing 5% of its portfolio in RMBS. Likewise, in *Barclays*, stating that "[m]inimum control requirements have been established for all key areas of identified risk" was too general to constitute a guarantee that it had specific control systems for potential manipulations of LIBOR. Finally, in *Bahash*, statements about the reputation and integrity of S&P was not a guarantee against the specific deficiencies alleged to have afflicted its ratings process.

In contrast, Goldman's representations about its purported controls for avoiding conflicts were directly at odds with its alleged conduct. For instance, Goldman represented that "[w]e have extensive procedures and controls that are designed to . . . address conflicts of interest" and "we increasingly have to address potential conflicts of interest, including situations where our services to a particular client or our own proprietary investments or other interests conflict, or are perceived to conflict, with the interest of another client . . . ." (Compl. ¶¶ 134, 154 (Form 10– K).) Meanwhile, Goldman is alleged to have sold financial products to clients despite clear and egregious conflicts of interest—indeed, where its "services to a particular client" (Paulson & Co. in the Abacus deal) and its "own proprietary investments" (in short positions in the Hudson, Anderson, and Timberwolf I deals) "conflict[ed] with the interest of [the] []other client[s]" investing in those deals. Particularly in light of Goldman's statements prior to the class period regarding its "aligned incentives" with its clients, the Court cannot say that as a matter of law no reasonable investor would have relied on the statements above in making an investment decision. *See* 17 C.F.R. § 240.10b-5 (whether omission is materially misleading is judged "in the light of the circumstances under which [the statements] were made"); *JP Morgan*, 553 F.3d at 197, 206 (statements not immaterial as a matter of law "unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance" or "too general to cause a reasonable investor to rely upon them").

The parties have seized upon the Court's observations about the financial crisis in a footnote in the prior decision. *See* 868 F. Supp. 2d at 277 n.8 ("If Goldman's claim of 'honesty' and 'integrity' are simply puffery, the world of finance may be in more trouble than we recognize."). The real issue in the prior decision was whether Plaintiffs had adequately alleged that Defendants made a material misstatement or misleading omission. On the basis of Defendants' statements regarding conflicts of interest alone, the Court adheres to its conclusion that Plaintiffs have pleaded a viable claim.

CONCLUSION

For the foregoing reasons, Defendants' motion for partial reconsideration is DENIED.

Dated: New York, New York
June 23, 2014

SO ORDERED

/s/ Paul A. Crotty
PAUL A. CROTTY
United States District Judge

[1] **CONFIDENTIAL**
UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

Master File
No. 1:10-CV-03461-PAC

IN RE GOLDMAN SACHS GROUP, INC.
SECURITIES LITIGATION

October 28, 2014
8:01 a.m.

Videotaped Deposition of DAVID VINIAR, taken by Plaintiffs, pursuant to Notice, held at the offices of Sullivan & Cromwell LLP, 125 Broad Street, New York, New York, before Todd DeSimone, a Registered Professional Reporter and Notary Public of the State of New York.

* * *

[14] Q. How about a failure to control for potential conflicts of interest [15] between Goldman and its customers, would that affect Goldman's reputation?

A. Yes, it would.

Q. Any examples you can recall of that happening?

A. I can recall more recent examples of people thinking that we had not handled a conflict particularly well. There was one with, I'm trying to remember the deal recently where an investment banker was representing a company and also owned stock in that company, and it was deemed to be, you know, a conflict.

Q. How about between Goldman Sachs and its clients or customers, any examples you recall of a breach of conflicts of interest policy that harmed Goldman's reputation?

A. Well, sure, there was the SEC suit on the Abacus case.

Q. And so you will agree that the SEC suit harmed Goldman's reputation?

A. Yes.

* * *

[1]** CONFIDENTIAL **
UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

Master File No. 1:10-cv-03461-PAC

IN RE GOLDMAN SACHS GROUP, INC.
SECURITIES LITIGATION

PURSUANT TO PROTECTIVE ORDER
Videotaped deposition of
JOHN D. FINNERTY, PH.D.
New York, New York
Thursday, March 19, 2015

Reported by: Annette Arlequin, CCR, RPR, CRR, CLR
Job No. 90764

* * *

[142] So when I read that body of information, I can form a judgment concerning what was disclosed in April 16th, April 30th, June 10th, and I can then run the statistical tests to see if the market reacts in a statistically significant way, but I'm forming my judgment as an economist before I look at the statistical test results.

Q. What are these -- what are the objective factors, if any, that you use to determine whether news is economically significant?

A. There's a large body of research that identify certain kinds of events that the market has reacted to in a significant way and therefore one can conclude that the market believes that these types of information are significant.

One type of information is fraud. If a company is accused of fraud by a regulatory body, that's bad news and the market reacts negatively.

* * *

[147] Q. So an allegation alleging the same offense but one in the form of a criminal complaint versus one in the form of a civil complaint could engender a different price reaction?

A. Yes, it could.

Q. Does this literature discuss the difference between, say, a regulatory complaint where it's filed and settled at the same time versus one where it's filed but not settled?

A. Yes, I think it does.

Q. And what does it say?

A. I don't recall, but I believe that's one of the issues that is covered, is it -- because you get resolution. If you announce the settlement and it gets resolved, that's [148] different from having the case filed and having uncertainties as to how it will come out. So certainly there's a difference in the timing of the reactions, and I believe that has been the subject of research, but I can't give you any citations off the top of my head.

Q. But why would there be a difference in impact of those two events?

A. The resolution of the uncertainty.

Q. The uncertainty of a case hanging out there?

A. Yes.

* * *

[1]** CONFIDENTIAL **
UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

Master File
No. 1:10-CV-03461-PAC

IN RE GOLDMAN SACHS GROUP, INC.
SECURITIES LITIGATION

May 1, 2015
9:07 a.m.

Videotaped Deposition of CHARLES PORTEN, taken by Plaintiffs, pursuant to Notice, held at the offices of Labaton Sucharow LLP, 140 Broadway, New York, New York, before Todd DeSimone, a Registered Professional Reporter and Notary Public of the State of New York.

---

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ALSO PRESENT:

VILDAN ALTUGLU, Cornerstone Research
DEVERELL WRITE, Videographer

[3] THE VIDEOGRAPHER: We are on the record. Please note that the microphones are sensitive and may pick up whispering and private conversations.

My name is Deverell Write representing Veritext Legal Solutions. Today's date is May 1st, 2015. The time on the video monitor is approximately [sic] a.m.

This deposition is being taken on behalf of the plaintiff in the case of In Re Goldman Sachs Group, Inc. Securities Litigation. This case is filed in the U.S. District Court for the Southern District of New York, case number 1:10-CV-03461. The name of the witness is Charles Porten.

At this time will counsel please state their appearances.

MR. ROGERS: Michael Rogers, Labaton Sucharow LLP, for plaintiffs and the class.

MR. DUBBIN: Jeff Dubbin from Labaton Sucharow as well.

[4] MR. COCHRAN: Brian Cochran from Robbins Geller for plaintiffs.

MR. REIN: David Rein, Sullivan & Cromwell LLP, for defendants.

MS. STOKES: Jessica Stokes, Sullivan & Cromwell LLP, for defendants.

MS. ALTUGLU: Vildan Altuglu from Cornerstone Research.

* * *

[4] CHARLES PORTEN, called as a witness, having been first duly sworn, was examined and testified as follows:

EXAMINATION BY MR. ROGERS:

Q. Good morning.

A. Good morning.

Q. Is it Mr. Porten or is it Dr. or Professor Porten?

A. Most people call me Charlie.

Q. I'm going to call you either by one of those titles though. Is it Dr. or Professor or are you just Mr. in this case?

A. Just Mr.

[5] Q. Okay, Mr. Porten. You can call me Mr. Rogers. We will get all those jokes out in advance. Have you had your deposition taken?

A. Yes.

Q. How many times approximately?

A. About 10, 12.

Q. And those 10 to 12 depositions, are those all in an expert capacity or were some of those where you were a party or a witness to a suit?

A. All in an expert capacity.

Q. And I only ask that right now just to make sure we all know the rules of the road. So you understand the basics.

I will ask questions, you will answer. We have to be careful not to talk over each other. There is a reporter taking down all of our words, so try to articulate answers, not just nod or shake your head. If at any time you need a break, let me know and as long as there is no question pending we will accommodate

* * *

[198][“]. . . However, appropriately identifying and dealing with conflicts of interest is complex and difficult, and our reputation could be damaged and the willingness of clients to enter into transactions in which such a conflict might arise may be affected if we fail, or appear to fail, to identify and deal appropriately with conflicts of interest. In addition, potential or perceived conflicts could give rise to litigation or enforcement actions.”

Did you consider whether this statement on page 289 of the Merrill Lynch report related to the misstatement as alleged in our complaint?

A. Yes.

Q. And your conclusion was?

A. As you read this report, it refers to discussion of private equity and then goes on to make some generalized statements about the importance of dealing with conflicts of interest.

There is no reference to any [199] statements the company made in its 10-Ks about conflicts of interest or in the conference call. He is just saying there were discussion of private equity, and he is going on to say that dealing with conflicts of interest is important, which is obvious, and he thinks the company does a good job of it.

There is no reference to what was reported in the 10-K or what was cited in the conference call. So I concluded this report did not make reference to the alleged misstatements.

Q. You just said you thought it is obvious that dealing with conflicts of interest is important; is that correct?

A. Yes.

Q. Important to whom?

A. To everyone.

Q. Including investors?

A. Yes.

Q. So it's important for investors whether a company manages its conflicts of interest, correct?

[200] A. Yes.

Q. And it was important to investors whether Goldman Sachs managed its conflicts of interest, correct?

A. Yes.

Q. Now, going back to the answer that you just gave a moment ago, is there any specific basis that you concluded that this statement about conflicts of interest does not relate to Goldman's statement about prevention of conflicts of interest and how its reputation could be damaged if conflicts arose?

MR. REIN: I object to the form, asked and answered.

A. He begins this paragraph referring to a discussion of private equity, and then he says it gives rise to concerns over conflicts, and then everything else that follows is his statement about why dealing with conflicts is important.

I see nothing here where he says he is citing specific statements made [201] in the 10-K or made in a conference call. He is talking about discussion of private equity and then going on to offer his viewpoint about the importance of managing conflicts of interest.

Q. So it's the absence of the citation to the 10-K that causes you to reach that conclusion?

MR. REIN: I object to the form, foundation, misstates testimony.

A. There is no reference in this statement that he is citing that the company made certain statements in its 10-K about conflicts of interest or in the conference call. He is referring to discussion of private equity and he has an a-ha moment. "Private equity gives rise to concerns over conflicts."

He goes on to make some general statements about he thinks the company does a good job.

Q. And what was his basis of concluding that he thinks the company was doing a good job; do you know?

[202] A. He says "The consistency with which the firm has avoided crossing the line and damaging its reputation is such that it must be doing something right."

That's his basis for saying that.

Q. And did you consider whether his basis for that conclusion was what Goldman said in its 10-K?

MR. REIN: I object to the form, foundation.

Q. Did you consider that possibility?

MR. REIN: I object to the form.

A. He is basing this, as he says at the outset, based on the discussion of private equity.

Q. Now, you said a few moments ago that it was obvious that conflict of interest management was important, right?

MR. REIN: I object to the form.

A. It is important to every firm.

[203] Q. And important to investors as well, correct?

A. Yes.

Q. So based upon that expert conclusion, do you conclude that it also would have been important on March 13th, 2007 if Goldman was failing to control for conflicts of interest?

MR. REIN: I object to the form.

A. Well, certainly if conflicts of interest are important, as I said they are, and if it's proven that a company failed to deal with conflicts, that would be important.

Q. Now, would you expect the Merrill Lynch analyst to say in his report "and I'm also very pleased to report that I'm not aware of any instances of Goldman violating its conflicts policies"? Would you expect him to say that?

MR. REIN: I object to the form.

A. No.

[204] Q. Now, you said a moment ago, though, that if conflicts of interest are important and if it is proven that a company failed to deal with conflicts, that would be important. You said that, right?

A. Yes.

Q. Now, would such a statement of that importance need to necessarily include the words "we failed to properly prevent conflicts"?

MR. REIN: I object to the form.

A. I'm not sure I understand your question.

Q. You said that information proving that a company failed to prevent conflicts would be important information, right?

MR. REIN: I object to the form, foundation.

A. Yes.

Q. And therefore if it is important analysts would address it, [205] correct?

A. Yes.

Q. Now, is it your expert testimony that any analyst discussing that important information, proving a failure to prevent conflicts, would only be valid if it said explicitly "and Goldman failed to prevent conflicts"; in other words, are there any other ways that information could be revealed other than saying "a failure to prevent conflicts"?

MR. REIN: I object to the form, foundation.

A. I don't know.

Q. I'm going to mark as Porten 8 a document that runs from the Bates number Porten 00012298 through 2309, a Merrill Lynch analyst report with a buy recommendation, July 28th, 2008, covering the Goldman Sachs Group, titled Position For Opportunity Amid Chaos.

(Porten Exhibit 8 marked for identification.)

Q. As always, feel free to review

* * *

[302] MR. REIN: I object to the form, foundation.

A. The time to buy or sell a company is really case specific.

Q. But, in other words, the idea that a particular company can have extremely harmful news come out in which its stock price plummets, but if the market believes that all the bad news is out and the future news is going to be good, it is a great time to buy, right?

MR. REIN: I object to the form, foundation.

A. It is case-specific.

Q. But what I just described is a possibility, correct?

MR. REIN: I object to form, asked and answered.

A. Anything is possible. In my opinion, what you are saying always happens to me is case-specific when it is time to buy or sell.

Q. Well, let's look at some of that specificity. It's not just a buy [303] recommendation, more specifically it's a buy high risk as a change from buy medium risk, correct?

A. But what carries the day is the buy recommendation.

Q. So you are saying his change of the word "medium risk" to "high risk" is meaningless?

MR. REIN: I object to the form, mischaracterization.

A. It's of much less significance than the fact that he is still carrying a buy recommendation.

What prevails in IBES reports where the analysts give their opinion and their target price and their earnings is just the opinion, not whether it is high or low risk. So that's not deemed to be of great significance in the industry.

Q. But in your expert opinion, information that affects a company's stock price will be addressed by analysts in their reports, correct?

A. Correct.

[304] Q. And this analyst talks about reputational risk and the possibility of follow-on lawsuits related to the SEC action, correct?

A. Correct.

Q. And Goldman's misstatement about its conflict of interests policies identified that its reputation could be damaged if conflicts arose as well as perceived conflicts could possibly give rise to litigation actions, correct?

MR. REIN: I object to the form, foundation.

Q. Is that correct, sir?

A. Yes, you properly read from my report.

Q. Let's mark as Porten 17 a document that's been Bates numbered PORTEN 00011802 through 807.

And this is a Merrill Lynch — excuse me, Bank of America Merrill Lynch, this is after the merger, April 16, 2010 report titled SEC Case Seems Limited, But Reputational Fall-Out Worrisome.

[305] (Porten Exhibit 17 marked for identification.)

Q. You will see that the first bullet point is entitled "SEC brings a civil fraud case relating to alleged misrepresentations" — strike that.

Before we go on, in your expert opinion, does what analysts focus on in the title of the report indicate the importance of a certain subject?

A. It could.

Q. How about in this case where they are saying "reputational fall-out is worrisome"?

A. Well, I haven't studied the whole report as to all the things he is saying and why he chose to give it the title he did.

Q. Would you agree that reputation is one of the concerns of this analyst in this report?

A. He is citing that the SEC case, while it seems limited, could result in some reputational fall-out.

* * *

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

No. 1:10-cv-03461-PAC

IN RE GOLDMAN SACHS GROUP, INC.
SECURITIES LITIGATION

CLASS ACTION
JURY TRIAL DEMANDED
ECF CASE

EXPERT REPORT OF
JOHN D. FINNERTY, Ph.D.

IN SUPPORT OF LOSS CAUSATION
AND DAMAGES

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I, John D. Finnerty, declare pursuant to 28 U.S.C. § 1746, as follows:

I. Qualifications

1. I am a Managing Director at AlixPartners, LLP, a financial and operational consulting firm. I have extensive experience in securities valuation, derivatives valuation, solvency analysis, business valuation, the calculation of damages, and litigation support for matters involving securities fraud, breach of contract, commercial disputes, valuation disputes, solvency, fairness, breach of fiduciary duty, and employment disputes involving the valuation of employee stock options. I have testified as an expert in securities and other financial matters, broker hiring disputes, and valuation disputes, in federal and state court and in arbitration and mediation proceedings. I have also testified as an expert in bankruptcy court concerning the valuation of securities and businesses and the fairness of proposed plans of reorganization.

2. Prior to joining AlixPartners, I was a Managing Principal at Finnerty Economic Consulting, LLC ("FinnEcon"), which provided financial consulting and valuation services to law firms, corporations, industry associations, and government agencies. Prior to forming FinnEcon in 2003, I was a Managing Principal at Analysis Group, Inc., an economic consulting firm. Prior to joining Analysis Group, I was a Partner (non-audit) in the PricewaterhouseCoopers Financial Advisory Services Group. I have also held investment banking positions at Morgan Stanley, Lazard Frères, McFarland Dewey, and Houlihan Lokey Howard & Zukin.

3. I am on leave from my position as a Professor of Finance at Fordham University's Graduate School of Business Administration, where I was the founding Director of the school's Master of Science in Quantitative Finance Program. I was awarded early tenure in 1991, and I received the Gladys and Henry Crown Award for Faculty Excellence in 1997. I have published 15 books, including *Corporate Financial Management*, 4th ed., *Project Financing*, 3rd ed., and *Debt Management*, and I have published more than 100 articles and professional papers concerning corporate finance, fixed income, and business and securities valuation.

4. I have previously published a paper on the calculation of damages in securities fraud cases entitled, "An Improved Two-Trader Model for Measuring Damages in Securities Fraud Class Actions," which was published in the Spring 2003 issue of the Stanford Journal of Law, Business & Finance. I have also published a paper on the settlement amounts in securities fraud class actions, entitled, "Determinants of the Settlement Amount in Securities Fraud Class Action Litigation," which was published in the Summer 2006 issue of the Hastings Business Law Journal. I have extensive experience testing for market efficiency, performing loss causation analysis, and calculating damages in securities fraud cases.

5. My teaching and research deal mainly with corporate finance, investment banking, fixed income securities valuation, fixed income portfolio management, and the design and valuation of complex securities. My corporate finance and investment banking courses cover business valuation and securities valuation, among other topics. My corporate

finance and fixed income courses cover derivative instruments and their use in designing and implementing investment and hedging strategies. I was inducted into the Fixed Income Analysts Society Hall of Fame in 2011.

6. I previously served as the Chair of the Trustees, President, and Director, and I am currently serving as a Trustee of the Eastern Finance Association, an academic finance organization. I am a former Director of the Financial Management Association. I have served as the President and Director of the Fixed Income Analysts Society, an association of finance professionals based in New York City. I am a former editor of *Financial Management*, one of the leading academic finance journals, and a former editor of *FMA Online*. I am an associate editor of the *Journal of Applied Finance* and a member of the editorial boards of the *Journal of Portfolio Management* and the *International Journal of Portfolio Analysis & Management*.

7. I received a Ph.D. in Operations Research from the Naval Postgraduate School, an M.A. in Economics from Cambridge University, where I was a Marshall Scholar, and a B.A. in Mathematics from Williams College. Attached as Appendix A is a true and correct copy of my current resume, which lists all publications I have written or co-authored and includes a brief description of my trial and deposition testimony within at least the past four years.

8. AlixPartners is being compensated at a rate of $1,020 per hour for my work on this matter. My compensation is not contingent on my findings or on the outcome of this matter. I have been assisted in the preparation of this expert report by AlixPartners's staff working under my direction and supervision.

9. Attached as Appendix B is a list of the documents I considered in coming to my opinions in this matter.

II. Assignment

10. Labaton Sucharow LLP ("Labaton") and Robbins Geller Rudman & Dowd LLP ("Robbins Geller"), co-counsel for the Plaintiffs in this matter (collectively "Counsel"), have asked me to (1) perform a loss causation analysis and opine on whether the declines in the price of the common stock of Goldman Sachs Group, Inc. ("Goldman" or the "Company") on the alleged disclosure dates were attributable to and substantially caused by identifiable news events relating to the disclosure of the fraud allegedly committed by Goldman during the period extending from February 5, 2007 through June 10, 2010, inclusive (the "Class Period") and (2) calculate the amount of damages per share experienced by class members who purchased shares of Goldman's common stock when the fraud-related inflation was removed from the stock price during the Class Period.

III. Summary of Opinions

11. I have reached the following opinions, after conducting appropriate studies, the results of which are described in this expert report:

a. Goldman's common stock price declined on April 16, 2010, April 26, 2010, April 30, 2010, and June 10, 2010 (the "Disclosure Dates") immediately following the public revelation of previously undisclosed facts regarding Goldman's fraudulent conduct concerning management of its conflicts of interest and its business principles;

b. The abnormal returns on Goldman's common stock on April 16, 2010, April 30, 2010, and June 10, 2010 are -9.27%, -7.75%, and -4.52%, respectively. These abnormal returns are all statistically significant. The abnormal return on April 26, 2010 is -1.68%, which is not statistically significant. Goldman's rebuttal and forthcoming Senate testimony the very next day appear to have muted the market's reaction.

c. The statistically significant abnormal returns on April 16, 2010, April 30, 2010, and June 10, 2010 were not due to any macroeconomic factors, industry-specific factors, or non-fraud-related Goldman news, but were substantially caused by a series of revelations concerning Goldman's alleged fraudulent conduct related to the management of its conflicts of interest and its business principles; and

d. The amount of damages suffered by purchasers of the shares of Goldman's common stock as a result of the disclosure of the truth about Goldman's fraudulent conduct on April 16, 2010, April 30, 2010, and June 10, 2010 is, in total, up to $35.70 per share, depending on when the shares were bought and sold during the Class Period.

12. These opinions are based on the results of the loss causation analysis and the damages calculations that are described in this expert report.

IV. Factual Background

A. The Four Synthetic CDOs at Issue in This Matter

13. The Complaint in this matter alleges that Goldman made a series of misrepresentations and

omissions with respect to four CDO transactions that Goldman structured and sold between December 2006 and April 2007. The four CDO transactions at issue in this matter are Abacus 2007-AC1, Hudson Mezzanine Funding 2006-1 ("Hudson 2006-1"), Anderson Mezzanine Funding 2007-1 ("Anderson 2007-1"), and Timberwolf 1.

* * *

88. For example, a *Financial Times* article announced that Whitehall Street International, Goldman's internal real estate fund, had lost almost all of its $1.8 billion of equity from its investments across U.S., Japan, and Germany, and that it was down to $30 million, according to the annual report sent to investors the preceding month.[69] This news article did not contain new information because the information was previously revealed in the fund's annual report to its investors.[70]

89. Another *Financial Times* article reported that Demand Media Inc., which sifts online search engine data, had hired Goldman for an initial public offering as early as August of 2010 that may value the company at $1.5 billion.[71] Such a transaction would occur normally in Goldman's investment banking business.

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[69] Financial Times, "Goldman real estate fund down to $30m," April 15, 2010; and SmarTrend News Watch, "Goldman Sachs Group, Inc. Affected by Real Estate Market Losses," April 16, 2010.

[70] Financial Times, "Goldman Real Estate Fund Down to $30m," April 16, 2010.

[71] Financial Times, "Demand Media enlists Goldman for IPO," April 15, 2010. Bloomberg News, "Demand Media Hires Goldman Sachs for IPO, FT Says," April 15, 2010.

90. The majority of news articles and securities analysts' reports released after the market close on April 15, 2010 through the market close on April 16, 2010 predominantly covered the SEC's law suit against Goldman in connection with Abacus 2007-AC1. (*See* Appendix B.) The SEC Complaint revealed that Goldman had been engaged in fraudulent conduct in connection with Abacus 2007-AC1, not adequately disclosing Paulson's involvement in the portfolio selection process and intentionally misleading ACA with respect to the CDO transaction. The confounding news released on this date was not economically significant.

91. In order to examine the impact of the news concerning the SEC Complaint and its allegations on the price of Goldman's common stock, I investigated Goldman stock price movements after the market close on April 15, 2010 through the market close on April 16, 2010. (*See* Exhibit 4.) As illustrated in the chart, on April 16, 2010, immediately after a news article concerning the SEC's regulatory enforcement action was released around 10:38 AM, the price of Goldman's common stock plunged more than 10 percent in the first half-hour of trading and stayed low throughout the day through the market close.

92. Thus, the abnormal return on Goldman's common stock of -9.27% on April 16, 2010 is attributable to the announcement of the SEC's regulatory enforcement action against Goldman. The SEC's regulatory enforcement action was, in fact, a direct consequence of Goldman's alleged fraudulent conduct in connection with Abacus 2007-AC1. Furthermore, the announcement of the SEC's regulatory enforcement action finally disclosed to market participants that Goldman had engaged in

undisclosed conflicts of interest and violated its business principles in contrast to the false and misleading statements during the Class Period.

93. Defendants' experts have argued that Goldman's stock price reaction on the Disclosure Date was due to the announcement of the SEC enforcement action by itself and was not due to the revelation of Goldman's fraudulent conduct in connection with the CDO transaction at issue.[72] However, the regulatory enforcement action by the SEC would not have been brought if there had been no evidence of fraudulent conduct with respect to the Abacus 2007-AC1 CDO transaction, which revealed that Goldman had made alleged false and misleading statements and omissions during the Class Period. I examined this argument and provided a complete rejection of it in the Finnerty Rebuttal Declaration.

94. Therefore, it is my opinion that the abnormal return of -9.27% on Goldman's common stock on April 16, 2010 is attributable to the corrective information revealed in the announcement of the SEC's regulatory enforcement action in connection with Abacus 2007-AC1. The SEC's fraud charge provided new information to the market that Goldman had been engaged in undisclosed conflicts of interest and violated its business principles in contrast to the false and misleading statements during the Class Period.

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[72] The Gompers Declaration, ¶¶ 61, 66, 81, and 91. Declaration of Stephen Choi, Ph.D., dated April 6, 2015 (the "Choi Declaration"), ¶¶ 18-19.

C. April 26, 2010

1) Corrective Disclosures with Regard to the Alleged False and Misleading Statements and Omissions

95. On Saturday, April 24, 2010, the Senate Subcommittee on Investigations announced the release of four emails, which indicated that Goldman made money betting against the CDOs it had sold to its clients.[73] In particular, Senator Carl Levin, chairman of the Senate Subcommittee on Investigations, noted that:

> Investment banks such as Goldman Sachs were not simply market-makers, they were self-interested promoters of risky and complicated financial schemes that helped trigger the crisis. They bundled toxic mortgages into complex financial instruments, got the credit rating agencies to label them as AAA securities, and sold them to investors, magnifying and spreading risk throughout the financial system, and all too often betting against the instruments they sold and profiting at the expense of their clients.[74]

96. He noted that the 2009 Goldman annual report stated that the Company "did not generate enormous

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[73] U.S. Senate Committee on Home Land Security & Governmental Affairs, "Senate Subcommittee Investigating Financial Crisis Releases Documents on Role of Investment Bank," April 24, 2010 and underlying exhibits (http://www.hsgac.senate.gov/subcommittees/investigations/media/senate-subcommittee-investigating-financial-crisis-releases-documents-on-role-of-investment-banks).

[74] *Ibid*.

net revenues by betting against residential related products. These e-mails show that, in fact, Goldman made a lot of money by betting against the mortgage market."[75]

97. In one of the internal Goldman emails dated November 18, 2007, Lloyd Blankfein, Goldman's Chief Executive Officer, wrote that "[o]f course we didn't dodge the mortgage mess. We lost money, then made more than we lost because of shorts."[76]

98. In other email correspondence dated July 25, 2007, Goldman's employees discussed Goldman's trading activities, which reveal that the Company netted over $50 million by taking short positions that increased in value. In the email, David Viniar, Goldman's Chief Financial Officer, wrote that the profit from short selling "[t]ells you what might be happening to people who don't have the big short."[77]

99. In email correspondence dated May 17, 2007, Goldman employees discussed the mortgage-related securities issued by Long Beach Mortgage Company and its charge-off of an unpaid principal balance.[78] In the email exchange, one employee, referencing a recent "wipeout" of one security issued by Long Beach Mortgage Company, wrote that another imminent wipe out would cost Goldman $2.5 million but that Goldman would make $5 million on its short position.

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[75] *Ibid*.

[76] *Ibid.*

[77] *Ibid.*, Exhibit 104, E-mail from David Viniar to Gary Cohn, subject: RE: Private & Confidential: FICC Financial Package 7/25/07.

[78] *Ibid.*, Exhibit 103, E-mail from Deeb Salem to Michael Swenson, subject: FW: LBML 06A.

100. In email correspondence dated October 11, 2007, discussing RMBS downgrades by Moody's, one of Goldman's managers wrote that, because of Goldman's short position, "[s]ounds like we will make some serious money."[79]

101. In response to the release of internal Goldman documents by the Senate Subcommittee, on April 24, 2010, a Goldman official stated that "the contents of some of the emails [were] embarrassing but showed no evidence of wrongdoing."[80] Goldman also published on its website a 12-page document, which included emails and revenue data regarding its mortgage-business risk management during 2007-08, to demonstrate that its subprime mortgage trading reflected prudent risk management rather than speculation.[81]

2) Abnormal Return Analysis

102. On Monday, April 26, 2010, Goldman's common stock price *decreased* 3.41% from $157.40 to $152.03. (*See* Exhibit 3.) Based on the Modified Fama-French Three-Factor Model, including the percentage change in the Industry Index as an explanatory variable, the abnormal return on April 26, 2010 is -1.68%, which is not statistically significant at the 10% level.

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[79] *Ibid.*, Exhibit 102, E-mail from Michael Swenson to Donald Mullen, subject: RE: Early post on P and L.

[80] Bloomberg News, "Goldman Vulnerable? Don't Ask Plaintiff Lawyers," April 25, 2010.

[81] Financial Times, "Goldman Releases Internal Paper Trail," April 25, 2010. Bank of America Merrill Lynch, "GS Publishes new '07-08 MBS e-mail, data," April 26, 2010.

103. However, the abnormal return may not have risen to a level of statistical significance at the 95% confidence level (more than 1.96 standard deviations from the mean) because of Goldman's immediate rebuttal and claims that its conduct was proper. It was also publicly known that Goldman executives, including its CEO, were going to testify before the Senate the following day. These facts may have led to the decline not being statistically significant.

3) Loss Causation Analysis

104. As discussed above, on Saturday, April 24, 2010, the Senate Subcommittee on Investigations released several internal Goldman documents, including emails and reports, which indicated that Goldman had made money betting against the CDOs it had sold to its clients.[82]

105. In response to the release of the internal Goldman documents, Bank of America Merrill Lynch published a securities analyst report on April 26, 2010, commenting on the recently released Goldman internal documents as well as Goldman's response. Bank of America Merrill Lynch securities analysts noted that:[83]

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[82] United State Senate Committee on Home Land Security & Governmental Affairs, "Senate Subcommittee Investigating Financial Crisis Releases Documents on Role of Investment Bank," April 24, 2010 and underlying exhibits (http://www.hsgac.senate.gov/subcommittees/investigations/media/senate-subcommittee-investigating-financial-crisis-releases-documents-on-role-of-investment-banks). Bloomberg News, "Goldman Fraud Charges: Emails and Internal Reports Revealed," April 26, 2010.

[83] Bank of America Merrill Lynch, "GS Publishes new '07-08 MBS e-mail, data," April 26, 2010, p. 3.

> Press reports over the weekend covered the e-mails released from the Subcommittee, which appear to show Goldman broadly shorting mortgages before and during the crisis. Goldman then released a broader group of emails, in an attempt to provide more context. GS is trying to make clear that its risk disciplines, in the face of huge market uncertainty, were designed to minimize the firm's exposure rather than take big directional bets.
>
> They do seem, in our view, to show considerable internal debate as to how the firm should be positioned (i.e., no clear "house" view that the firm should be short), and a general mandate, in our opinion, from top management that the firm should be basically "close to home" in the MBS market, i.e. not significantly exposed one way or the other.

106. I have reviewed the media databases on Bloomberg, Thomson Research, and other news sources for Goldman-related news articles published after the market close on Friday April 23, 2010 through the market close on Monday April 26, 2010. I did not find any additional notable news items regarding Goldman that received any news coverage during that time period.

107. Goldman's denial of the Senate Committee's allegations in conjunction with the upcoming Senate testimony likely led to a more muted market reaction. Since the abnormal return on Goldman's common stock on April 26, 2010 was not statistically

significant, I excluded the abnormal return on April 26, 2010 from my damages calculation.

D. April 30, 2010

1) Corrective Disclosures with Regard to the Alleged False and Misleading Statements and Omissions

108. On Thursday, April 29, 2010 after the market closed, the *Wall Street Journal* reported that the Department of Justice (DOJ) had opened a criminal investigation into whether Goldman or its employees had committed securities fraud in connection with Goldman's mortgage trading.[84] This criminal investigation was announced after a Senate hearing that was held on April 27, 2010, where Goldman employees were questioned regarding its fraudulent conduct in connection with certain CDOs that Goldman structured and sold. Therefore, as part of my review of the Disclosure Date of April 30, 2010, the first trading day after the disclosure of the DOJ investigation, I also reviewed the information that was released into the market on April 27, 2010.

109. On Tuesday, April 27, 2010, the Senate's Permanent Subcommittee on Investigations held a hearing, where seven employees of Goldman appeared in front of the subcommittee, to examine the role that Goldman played in the credit crisis, particularly in connection with sub-prime mortgage securitization.[85]

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[84] New York Times, "U.S. Said to Open Criminal Inquiry Into Goldman," April 29, 2010.

[85] Hearings before the Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs United States Senate, "Wall Street and the Financial Crisis: The Role of Investment Banks," April 27, 2010 (the "April 27, 2010 Senate Hearings").

In addition to the SEC's enforcement action concerning the Abacus 2007-AC1 CDO, the Subcommittee claimed that Goldman devised a series of transactions (and not just a single CDO transaction)[86] to profit from the collapse of the home mortgage market.

110. In the hearing, Senator Carl Levin, the chairman of the Senate's Permanent Subcommittee on Investigations, asserted that Goldman repeatedly placed its own interests and profits ahead of its clients' interest,[87] and profited substantially by betting against its own clients in connection with synthetic CDOs.[88] In highlighting Goldman's fraudulent conduct, Senators referenced the Abacus 2007-AC1, Hudson 2006-1, Timberwolf 1, and Anderson 2007-1 CDO transactions.[89]

111. For example, Senator Levin noted that "Anderson Mezzanine Funding 2007-1 was a synthetic product assembled by Goldman... and [Goldman] sold Anderson securities to its clients without disclosing that it would profit if those securities suffered losses."[90] In particular, Senator Levin emphasized that, instead of responding to clients' questions and disclosing Goldman's significant short position in the CDO tranches, Goldman had continued to "push hard" on its clients to buy the Anderson 2007-1 CDO.

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[86] *Ibid.*, pp. 6-7. For example, Senator Levin noted that "Abacus may be the best-known example of conflicts of interest revealed in the Goldman documents, but it is far from the only example."

[87] *Ibid.*, p. 3.

[88] *Ibid.*, pp. 4-5.

[89] *Ibid.*, pp. 6, 19, 24, 39, and 60.

[90] *Ibid.*, pp. 6-7.

Goldman did not properly disclose its short position and misrepresented to clients that it was holding the equity tranche, and thereby misled clients into believing that Goldman was taking only the long side of the CDO transaction.[91]

112. Senator Levin also discussed Goldman's conflicts of interest in connection with the Timberwolf 1 CDO, which consisted of low-quality assets.[92] He asserted that, while Goldman was taking short positions against the Timberwolf 1 CDO to protect itself, Goldman continued to sell this CDO to clients without adequately disclosing to them the risks associated with the CDO. He quoted internal Goldman email correspondence dated June 22, 2007, in which Goldman employees discussed its mortgage-linked securities. In the email, Tomas Montag, the former head of sales and trading at Goldman, wrote "[b]oy that Timberwo[l]f was one shi**y deal."[93]

113. The Senate committee also examined the Hudson 2006-1 CDO, which Goldman allegedly structured to "shift risks" from Goldman's balance sheet to investors.[94] Senator Ensign stated, in reference to the Hudson 2006-1 CDO, that:[95]

> It was a synthetic CDO that referenced $2 billion in subprime BBB-rated mortgage-backed securities. Goldman selected the referenced assets. The purpose of the transaction appears to have been to get those

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[91] *Ibid.*, p. 22.

[92] *Ibid.*, pp. 24-25.

[93] *Ibid.*, pp. 24-25.

[94] *Ibid.*, p. 60.

[95] *Ibid.*, p. 60.

> assets off Goldman's own books. Basically Goldman was the only buyer to see this CDO and then make a bet against it.

114. Senator Levin also noted that Goldman's marketing booklet for the Hudson 2006-1 CDO only disclosed one side of Goldman's position.[96] The Executive Summary section of the marketing booklet stated that "Goldman Sachs has aligned incentives with the Hudson program by investing in a portion of equity and playing the ongoing role of Liquidation Agent."[97] In fact, it was revealed in an internal Goldman email dated October 30, 2006 that "Goldman was the sole buyer of protection on the entire $2.0 billion of assets."[98]

115. In response to the Senate's allegations in the hearing, Goldman executives and managers repeatedly denied the allegations and defended their actions, and they emphasized that Goldman had always tried to balance its portfolio investments so that Goldman would not have a long or short net position.

116. For example, Lloyd Blankfein, Goldman's Chief Executive Officer, defended the Company's practice by stating that "we certainly did not bet against our client."[99] Tourre, executive director in the Structured Products Group, who was mainly responsible for structuring and organizing the Abacus

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[96] *Ibid.*, p. 71.

[97] *Ibid.*, p. 554.

[98] *Ibid.*, p. 588.

[99] *Ibid.*, p. 132.

2007-AC1 transaction, also denied the SEC's allegations.[100]

117. Two days later, on Thursday, April 29, 2010 after the market closed, the *Wall Street Journal* reported that the DOJ had opened a criminal investigation.[101] The article noted that the investigation was led by the Manhattan US Attorney's office and stemmed from a referral from the SEC. The *Wall Street Journal* also reported that the criminal investigation was centered on different evidence than the SEC's civil case but that it was unable to determine which of Goldman's deals were being scrutinized in the investigation.

118. The *Washington Post* also published an article on April 29, 2010, covering the DOJ's criminal investigation into Goldman, reporting that:[102]

> The Justice Department usually investigates high-profile cases of securities fraud, but the threshold for criminal prosecution is significantly higher than that of civil cases . . . It is rare for the government to indict a firm, and even the threat of criminal prosecution can doom a company.

119. The *Washington Post* published another article on April 30, 2010, covering the same issue, reporting that:[103]

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[100] *Ibid.*, pp. 17-18.

[101] New York Times, "U.S. Said to Open Criminal Inquiry Into Goldman," April 29, 2010.

[102] Washington Post, "Goldman May Be Prosecuted," April 29, 2010.

[103] Washington Post, "Justice Department Opens Goldman Sachs Criminal Investigation, Sources Say," April 30, 2010.

> It was not immediately clear if the FBI and prosecutors are probing different mortgage-related transactions than those at issue in the civil case.

120. *The Washington Post* published a follow-up article on the same day, reporting that:[104]

> The Justice Department's criminal investigation into Goldman Sachs goes beyond the financial transactions targeted by the Securities and Exchange Commission in the civil fraud suit brought against the firm last month, the law enforcement sources said Friday.
>
> The Justice Department probe began weeks ago and is essentially on a parallel track with the SEC investigation, the sources said. While prosecutors and investigators are focusing on some of the same mortgage-related transactions as the SEC, the sources said, the Justice Department cast a wider net.

121. A few days later on May 5, 2010, in response to the news concerning the DOJ's criminal investigation, Fitch Ratings also released a report, in which it lowered Goldman's rating outlook to Negative from Stable confirming that the DOJ's investigation provided additional new information to the market participants. [105]Fitch Ratings stated in the release that:

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[104] Washington Post, "Justice Probe of Goldman Goes Beyond Deals Cited By SEC," April 30, 2010.

[105] Bloomberg News, "Fitch Affirms Goldman Sachs at 'A+/F1+'; Outlook to Negative," May 5, 2010.

> The Rating Outlook revision to Negative incorporates recent legal developments and ongoing regulatory challenges that could adversely impact Goldman's reputation and revenue generating capacity. Goldman's franchise and market position are potentially vulnerable to scrutiny by stakeholders, and like peers, may be affected by the industry's regulatory evolution.
>
> Subsequent to civil fraud charges filed by the Securities and Exchange Commission (SEC) last month, it appears that the U.S. Attorney's Office in Manhattan is initiating a criminal probe in connection with Goldman's mortgage trading activities. Given the level of recent public scrutiny, it is not surprising that other authorities outside of the U.S. have also expressed intentions to investigate select mortgage-related transactions conducted by Goldman. At minimum, Fitch believes the civil charges to date and the pending criminal investigation, coupled with a highly public hearing by the U.S. Senate's Permanent Subcommittee on Investigations, generate adverse publicity that tarnishes Goldman's reputation. And for financial services companies, particularly those dependent on the capital markets, reputation is critically important.
>
> While not expected, Fitch believes Goldman's franchise is at greater risk in the event the company was to be the recipient of a formal criminal indictment.

122. While Goldman consistently denied the SEC's charges, the criminal investigation by the DOJ

disclosed, with respect to other CDOs in addition to the Abacus 2007-AC1 CDO, that Goldman did not have extensive procedures to control conflicts of interest with its clients and did not comply with its business principles, in contrast to what the Company had consistently stated in its public announcements.

123. In sum, the *Wall Street Journal* article reporting DOJ's criminal investigation into Goldman's potential securities fraud in connection with certain CDO transactions provided new information to the market regarding the severity of Goldman's conflicts of interest and violations of its business principles in contrast to the false and misleading statements during the Class Period.

2) Abnormal Return Analysis

124. On Friday, April 30, 2010, Goldman's common stock price *decreased* 9.39% from $160.24 to $145.20. (*See* Exhibit 3.) Based on the Modified Fama-French Three-Factor Model, including the percentage change in the Industry Index as an explanatory variable, the abnormal return on April 30, 2010 is -7.75%, which is statistically significant at the 1% level. Such a significance level means that there is less than a 1 in 100 chance that the abnormal return happened by mere chance.

3) Loss Causation Analysis

125. As discussed above, on Thursday, April 29, 2010, after the market closed, the *Wall Street Journal* reported that US federal prosecutors had opened a criminal investigation into whether Goldman or its employees had committed securities fraud in

connection with its mortgage trading.[106] The *Washington Post* also reported that the DOJ's criminal prosecution could potentially "doom a company." [107]

126. Subsequent to the *Wall Street Journal* news report concerning the DOJ's criminal investigation, Bank of America Merrill Lynch issued a securities analyst report on April 30, 2010, and reduced its rating stating that: [108]

> We are lowering our rating on GS to Neutral from Buy and our price objective to $160 from $220. Our downgrade is prompted by news reports filed Thursday evening by the media including the Wall St. Journal indicating that federal prosecutors have opened an investigation of GS in connection with its trading activities, raising the possibility of criminal charges.
>
> However, it is very difficult to see the shares making further progress until the matter has been resolved.

127. Standard & Poor's Equity Research Group cut its investment recommendation on Goldman's stock to Sell from Hold and lowered its price target by $40 to $140, stating that "we think the risk of a formal securities fraud charge, on top of the SEC fraud charge

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[106] New York Times, "U.S. Said to Open Criminal Inquiry Into Goldman," April 29, 2010.

[107] Washington Post, "Goldman May Be Prosecuted," April 29, 2010.

[108] Bank of America Merrill Lynch, "Goldman Sachs – Cutting to Neutral: concerns over reports of Federal probe," April 30, 2010.

and pending legislation to reshape the financial industry, further muddies Goldman's outlook."[109]

128. Buckingham Research Group downgraded Goldman's stock to Neutral from Buy, noting that they were not convinced that Goldman's issues would be resolved in the near-term, which would leave a significant amount of uncertainty in Goldman's stock for some time.[110]

129. Additionally, I have also reviewed a few analyst reports published after April 30, 2010, which continued to comment on the DOJ's criminal investigation into Goldman.

130. On May 2, 2010, Citigroup Global Market issued a securities analyst report, extensively covering Goldman's legal risk and the potential for regulatory reform. The report highlighted, among other issues, the recent regulatory enforcement actions brought by the SEC and the DOJ stating that (emphasis supplied):[111]

> It appears the civil case against Goldman is focused on a single transaction and is based on disclosure issues and questions of misrepresentation.
>
> Additional lawsuits from other investors remains a risk.

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[109] Bloomberg News, "Goldman Shares Slide on Criminal-probe Concerns," April 30, 2010.

[110] Buckingham Research Group, "Goldman Sachs: Downgrade to Neutral; Litigation/Political Risk Too Difficult to Handicap," April 30, 2010.

[111] Citigroup Global Markets, "Goldman Sachs Group, Inc. (GS), Reiterate Buy – Risks Are There, But Still See Significant Upside," May 2, 2010, pp. 8-9.

> Reputational risk could damage Goldman's franchise – While we do not believe at this point Goldman's institutional client base has altered their business practices at this point, **Goldman's reputation is one of the firm's greatest assets. To the extent clients lose faith and either reduce or eliminate their transactions with Goldman, it could have significant detrimental effect across all of the firm's business.**
>
> Potential implications to securities dealer of criminal charges – There are several potential implications of the filing of criminal charges against a securities dealer. Trading counterparties could pull back from the firm. Investment banking clients could also turn away from a firm, for fear of deals being tainted by reputation of the charged firm.
>
> Potential implications to criminal conviction for a securities firm are severe – If a securities firm were convicted of criminal fraud, then it could lose its license as a primary treasury dealer; broker dealer licenses to sell securities could also be revoked.

131. On May 5, 2010, in response to the news concerning the DOJ's criminal investigation, Fitch Ratings also released a report, in which it lowered Goldman's rating outlook to Negative from Stable confirming that the DOJ's investigation provided significant new information to the market participants.[112]

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[112] Bloomberg News, "Fitch Affirms Goldman Sachs at 'A+/F1+'; Outlook to Negative," May 5, 2010.

132. I have reviewed the media databases on Bloomberg, Thomson Research, and other news sources for Goldman-related news articles published after the market close on Thursday, April 29, 2010 through the market close on Friday, April 30, 2010. I did not find any additional notable news items regarding Goldman that received any news coverage during that time period.

133. The majority of news articles and securities analysts' reports released after the market close on April 29, 2010 through the market close on April 30, 2010 mainly covered the news regarding the DOJ's criminal investigation into certain Goldman CDO transactions.

134. In order to examine the impact of the news concerning the DOJ's criminal investigation on the price of Goldman's common stock, I investigated Goldman stock price movements in response to the disclosure of the DOJ's criminal investigation. (*See* Exhibit 5.) As illustrated in the chart, a news article concerning the DOJ's criminal investigation was released on April 29, 2010 after the market had closed. Before the market opened on April 30, 2010, Bank of America Merrill Lynch analysts published an analyst report, in which they downgraded Goldman's stock rating. Following the news regarding the DOJ criminal investigation, the opening price of Goldman's stock on April 30, 2010 was significantly lower than the previous day's closing price. Subsequently, Goldman's stock price did not show any significant reaction through the market close on that day.

135. Thus, the abnormal return on Goldman's common stock of -7.75% on April 30, 2010 is attributable to the news announcement of the DOJ's criminal investigation into Goldman's CDO

transactions, including securities analysts' downgrades in response to the news. The DOJ's criminal investigation was, in fact, a direct consequence of Goldman's alleged fraudulent conduct in connection with certain CDOs other than Abacus 2007-AC1.

136. The news about the DOJ's criminal investigation provided significant new information about the severity of Goldman's conflicts of interest and violations of its business principles in contrast to its false and misleading statements during the Class Period.

137. Therefore, it is my opinion that the abnormal return of -7.75% on Goldman's common stock on April 30, 2010 is attributable to the corrective information revealed in the announcement of the DOJ's criminal investigation.

E. June 10, 2010

1) Corrective Disclosures with Regard to the Alleged False and Misleading Statements and Omissions

138. On Wednesday, June 9, 2010, after the market closed, it was reported that the Hudson 2006-1 CDO, which was sold in 2006, was also the target of a probe by the SEC in addition to the Abacus 2007-AC1 CDO.[113] Internal Goldman emails released in April 2010 revealed one October 2006 email, in which a Goldman employee had described how the Hudson 2006-1 transaction might have been viewed by

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[113] Bloomberg News, "Goldman Sachs Hudson CDO Said to Be Probed by SEC (Update1)," June 9, 2010. Bloomberg News, "Goldman Sachs Hudson CDO Said to Be Target of Second SEC Probe," June 10, 2010.

investors as "junk."[114] It was also alleged that, while Goldman was shorting the Hudson 2006-1 CDO, a marketing document distributed to its CDO investors stated that "Goldman Sachs has aligned incentives with the Hudson program."[115]

139. Senator Levin criticized Goldman at the Senate hearing held on April 27, 2010, noting that Goldman's sales of CDOs such as Hudson 2006-1 raised "a real ethical issue." The additional SEC investigation in connection with Hudson 2006-1, however, implied that the issue might be beyond "an ethical issue."

140. In sum, while several internal Goldman emails mentioning Hudson 2006-1 were previously released in April 2010 and private litigation by investors may have been expected, the second SEC probe into a Goldman CDO transaction provided significant new information regarding the severity of Goldman's conduct and revealed that Goldman had been engaged in undisclosed conflicts of interest and violated its business principles in contrast to the false and misleading statements during the Class Period.

2) Abnormal Return Analysis

141. On Thursday, June 10, 2010, Goldman's common stock price *decreased* 2.21% from $136.80 to $133.77. (*See* Exhibit 3.) Based on the Modified Fama-French Three-Factor Model, including the percentage change in the Industry Index as an explanatory variable, the abnormal return on June 10, 2010

[114] E-mail from Darryl Herrick to Tetsuya Ishikawa, "RE: Hudson Mezz," October 12, 2006, and the April 27, 2010 Senate Hearings, Exhibit 170c.

[115] The April 27, 2010 Senate Hearings, Exhibit 87.

is -4.52%, which is statistically significant at the 5% level. Such a significance level means that there is less than a 1 in 20 chance that the abnormal return happened by mere chance.

3) Loss Causation Analysis

142. As discussed above, after the market closed on Wednesday, June 9, 2010, it was reported that Goldman's $2 billion Hudson 2006-1 CDO was also the target of a probe by the SEC (in addition to the Abacus 2007-AC1 transaction).[116]

143. Following the announcement of a second SEC investigation into Goldman's CDO transactions, this one concerning Hudson 2006-1, Wells Fargo issued an analyst report concerning Goldman's short-term "tough" environment after the market close. Wells Fargo noted that near-term challenges for Goldman's stock were likely to persist, although it believed that a settlement with the SEC in the future would be positive for Goldman's stock. Wells Fargo also noted that media reports of a second SEC investigation into Goldman's CDO marketing practices, specifically the Hudson 2006-1 CDO, pushed Goldman shares down as much as 4% that day.[117]

144. I have reviewed the media databases on Bloomberg, Thomson Research, and other news sources for Goldman-related news articles published

[116] Bloomberg News, "Goldman Sachs Hudson CDO Said to Be Probed by SEC (Update1)," June 9, 2010. Bloomberg News, "Goldman Sachs Hudson CDO Said to Be Target of Second SEC Probe," June 10, 2010.

[117] Wells Fargo Equity Research, "The Goldman Sachs Group, Inc. – GS: Reiterating Outperform Rating Despite Near-Term Volatility," June 10, 2010.

after the market close on Wednesday, June 9, 2010 through the market close on Thursday, June 10, 2010. I identified other Goldman-specific news unrelated to the alleged fraud, which was not economically significant. For example, it was reported that Bank of America Corp. and Goldman were attempting to remove $5 billion in debt from their books in connection with loans they had made to help finance the buyout of Hilton Worldwide.[118] Such a transaction would occur normally in Goldman's investment banking business.

145. I did not find any additional notable news articles regarding Goldman that received any news coverage after the market close on June 9, 2010 through the market close on June 10, 2010.

146. In order to examine the impact of the news concerning the second SEC probe concerning Hudson 2006-1 on the price of Goldman's common stock, I investigated Goldman stock price movements after the market close on June 9, 2010 through the market close on June 10, 2010. (*See* Exhibit 6.) As illustrated in the chart, a news article concerning the second SEC investigation was released on June 9, 2010 after the market close. On June 10, 2010 in the morning, the price of Goldman's common stock was lower than the previous day's closing price. Subsequently, Goldman's stock price exhibited some volatility but did not increase or decrease significantly through the market close on that day.

147. Thus, the abnormal return on Goldman's common stock of -4.52% on June 10, 2010 is substantially attributable to the news announcement

[118] Bloomberg News, "Bank of America, Goldman Said to Offer $5 Billion Hilton Debt," June 10, 2010.

of the SEC investigation into Goldman's Hudson 2006-1 transaction. The second SEC investigation was, in fact, a direct consequence of Goldman's alleged fraudulent conduct in connection with Hudson 2006-1. Furthermore, the news report of the second SEC investigation disclosed to market participants the severity of Goldman's conduct and revealed that Goldman had been engaged in undisclosed conflicts of interest and violated its business principles in direct contrast to the false and misleading statements during the Class Period.

F. Overall Conclusion Regarding Loss Causation

148. It is my opinion that the abnormal return of -9.27% on Goldman's common stock on April 16, 2010 is attributable to the corrective information revealed in the announcement of the SEC's regulatory enforcement action in connection with Abacus 2007-AC1.

149. It is my opinion that the abnormal return of -1.68% on Goldman's common stock on April 26, 2010 is attributable to the corrective information revealed in several internal Goldman documents released by the Senate Committee on Investigations. Nonetheless, due to the factors discussed in paragraph 104 in this expert report, the abnormal return on Goldman's common stock on April 26, 2010 was not statistically significant. Thus, I excluded the abnormal return on April 26, 2010 from my damages calculation.

150. It is my opinion that the abnormal return of -7.75% on Goldman's common stock on April 30, 2010 is attributable to the corrective information revealed in the announcement of the DOJ's criminal investigation.

151. It is my opinion that the abnormal return of -4.52% on Goldman's common stock on June 10, 2010 is attributable to the corrective information revealed in the announcement of the SEC's second Goldman investigation, this one concerning the Hudson 2006-1 CDO.

* * *