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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: BARBARA R. KAPNICK PART 39

Index Number : 650027/2011
ACA FINANCIAL GUARANTY
vs
GOLDMAN, SACHS & CO.
Sequence Number : 002
DISMISS ACTION

INDEX NO. 650027/11
MOTION DATE
MOTION SEQ. NO. 002
MOTION CAL. NO.

The following papers, numbered 1 to ____ were read on this motion to/for ____

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☒ No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: 4/23/12

BARBARA R. KAPNICK J.S.C.

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

☐ SUBMIT ORDER/ JUDG. ☐ SETTLE ORDER/ JUDG.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IA PART 39

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ACA FINANCIAL GUARANTY CORP.,

Plaintiff,

- against -

GOLDMAN, SACHS & CO.,

Defendants.

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DECISION/ORDER
Index No. 6500027/11
Motion Seq. No. 002

BARBARA R. KAPNICK, J.:

In this action, plaintiff ACA Financial Guaranty Corp. ("ACA"), a monoline bond insurance company now operating in run-off, alleges that defendant Goldman, Sachs & Co. ("Goldman Sachs") fraudulently induced it to provide financial guaranty insurance for a structured finance product - a synthetic collateralized debt obligation ("CDO") which Goldman Sachs called ABACUS 2007-ACI ("ABACUS") - based on a portfolio of investment securities selected largely by its hedge fund client, Paulson & Co., Inc. ("Paulson"), which was designed to fail so that Paulson could reap huge profits and Goldman Sachs could reap huge fees.

Goldman Sachs allegedly deceived ACA into believing that Paulson was to be the "equity" investor - i.e., a long investor - in that product, when, in fact, Goldman Sachs knew that Paulson intended to take a short position in ABACUS, thereby taking an economic position in the transaction precisely contrary to ACA's position as insurer. Amended Complaint ("AC" or the "Complaint"), ¶ 1. Had Paulson's true role as a short investor selecting the portfolio been known, ACA claims, neither it nor anyone else would have provided financial guaranty insurance for ABACUS. AC, ¶ 2.

Background

According to the Amended Complaint, in late 2006, Paulson approached Goldman Sachs seeking a way to take a massive short position on subprime residential mortgage backed securities ("RMBS"), which are essentially pools of residential mortgages that have been repackaged into bonds. ABACUS was a synthetic CDO referencing a portfolio of RMBS, which allegedly enabled Paulson to do precisely that. AC, ¶ 10.

A CDO is an asset-backed security based on a portfolio of fixed-income collateral, such as RMBS. To establish a CDO, an investment bank incorporates a special purpose vehicle ("SPV") to which equity investors contribute capital. The SPV raises additional capital by issuing notes. In the most common type of CDO, known as a "cash flow" CDO, the SPV uses the proceeds of the notes to purchase collateral and makes payments on the notes out of the cash flow generated by the collateral. AC, ¶ 11. The notes are divided into different classes of risk, known as "tranches." Payment on the notes are made in order of seniority. AC, ¶ 12.

A credit default swap ("CDS") is an over-the-counter (i.e., not traded on a 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. AC, ¶ 15.

A synthetic CDO - such as ABACUS was - combines a CDO and CDSs. The SPV does not purchase a portfolio of collateral but instead acts as the protection seller in one or more CDSs referencing a portfolio of collateral (the "reference portfolio"). AC, ¶ 17.

Thus, a synthetic CDO is a mechanism to profit on a massive scale from the failure of the collateral specified in the reference portfolio. The protection sellers, including the financial guarantor of the super senior tranche of the capital structure, and the noteholders take the long position - meaning they both take the position that the reference portfolio will perform - while the protection buyers take the short position - meaning they take the position that the reference portfolio will default. AC, ¶ 19.

Goldman Sachs was the investment bank that structured ABACUS and placed ABACUS notes. Goldman Sachs also underwrote ABACUS by purchasing protection from the SPV through a CDS referencing the portfolio. AC, ¶ 23.

Paulson was the transaction sponsor of ABACUS. Paulson paid Goldman Sachs $15 to $20 million to structure, underwrite, and sell ABACUS; specified the parameters of the collateral to be included in the reference portfolio; specified the RMBS to be included in the "initial reference portfolio"; proposed additional RMBS to be included in the final reference portfolio; and vetoed specific RMBS that ACA proposed be included in the final reference portfolio. AC, ¶ 24. The transaction sponsor customarily pre-commits to invest in the CDO by taking a long position in the equity tranche. AC, ¶ 21.

Goldman Sachs allegedly misrepresented to ACA that Paulson had pre-committed to take a long position in ABACUS - *i.e.*, that Paulson had an economic incentive to select reference obligations that would perform. In fact, through a separate CDS between Goldman Sachs and Paulson (the "Goldman Sachs-Paulson CDS") that Goldman Sachs concealed from ACA, Paulson purchased from Goldman

Sachs the protection on the reference portfolio that Goldman Sachs had purchased from the SPV, making Paulson the ultimate and undisclosed protection buyer (*i.e.*, the short investor)in ABACUS, meaning that Paulson in fact had an economic incentive to select reference obligations that would *default*. According to ACA, the Goldman Sachs-Paulson CDS was not discoverable through any publicly available source of information. AC, ¶ 25.

ACA Management, LLC, a wholly owned subsidiary of ACA ("ACAM"), was the pro forma portfolio selection agent for ABACUS, i.e., ACAM agreed to and relied upon a portfolio largely selected by Paulson. AC, ¶ 26.[1]

According to ACA, by 2006 Paulson was convinced that the market for subprime RMBS was on the verge of collapse. Not satisfied with the enormous profits it already expected to make by shorting individual RMBS and other securities linked to residential mortgages, Paulson sought a way to make a billion dollar profit on the failure of a portfolio of RMBS through a single transaction. Paulson did not want to take the short position in just any portfolio of RMBS but in a portfolio of RMBS that it had selected and believed was most likely to default. AC, ¶ 28. Thus, in

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[1] Goldman Sachs, however, points out that ACA was contractually obligated by the Engagement Agreement to "determine and select" the reference portfolio and could have rejected Paulson's recommendations in the exercise of its contractual obligations.

December 2006, Goldman Sachs set out to identify a portfolio selection agent for ABACUS. AC, ¶ 35.

At least one investment bank that Paulson approached before approaching Goldman Sachs declined to assist Paulson out of concern for its reputation. 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 CDO's, 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 Stearns'] 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 else was shorting on the other side." AC, ¶ 30.

On January 4, 2007, Goldman Sachs approached GSC Partners ("GSC"), an institutional investment manager, to act as the portfolio selection agent for ABACUS. At a meeting the next day, Goldman Sachs and Paulson expressly disclosed that Paulson intended to short the reference portfolio of ABACUS. GSC declined to act as the portfolio selection agent because ABACUS posed "reputational risk" for GSC and the CDO market as a whole. Indeed, on February 27, 2007, when Goldman Sachs began to market ABACUS notes, a senior trader at GSC sent an e-mail to the head of Goldman Sachs's CDO

Origination Desk, stating: "I do not have to say how bad it is that you guys are pushing this thing." AC, ¶ 37.

On January 8, 2007, ACAM met with Paulson at Paulson's offices in New York City, where they discussed the proposed transaction, including among other things, the RMBS to be included in the reference portfolio. In contrast to the candid disclosure to GSC of Paulson's short interest in ABACUS, Paulson did not disclose to ACAM that Paulson intended to short the reference portfolio. AC, ¶ 39. In an e-mail regarding this meeting sent later on January 8, 2007, ACAM expressly asked Goldman Sachs how Paulson intended to "participate" in ABACUS. Although Goldman Sachs responded to the e-mail, it didn't tell ACAM that Paulson intended to "participate" by shorting the reference portfolio. AC, ¶ 40.

In a January 10, 2007 e-mail to ACA purporting to provide a "Transaction Summary," Goldman Sachs allegedly affirmatively and fraudulently misrepresented that Paulson and ACAM shared a common economic interest in ABACUS by representing that the "compensation structure *aligns everyone's incentives*: the Transaction Sponsor [*i.e.*, Paulson], the Portfolio Selection Agent [*i.e.*, ACAM] and Goldman." (emphasis supplied). In fact, Goldman Sachs knew that the economic interests of Paulson and ACAM in ABACUS were in direct conflict. AC, ¶ 41.

Goldman Sachs also misrepresented in that e-mail that among all of the investors taking a long position in ABACUS, Paulson had the greatest risk of loss. In fact, as Goldman Sachs knew, and contrary to its misrepresentations to ACA, Paulson never intended to take an equity position in ABACUS but instead always intended to short the ABACUS portfolio. AC, ¶ 43.

On January 14, 2007, an ACAM Managing Director sent an e-mail to a Goldman Sachs sales representative, in which ACAM specifically referred to Paulson's "equity perspective" in ABACUS. Although Goldman Sachs replied to ACAM's e-mail, Goldman Sachs did not correct ACAM's manifest misunderstanding that Paulson was to invest in the equity of ABACUS. By undertaking to characterize Paulson's economic interest in the transaction, Goldman Sachs assumed a duty to disclose Paulson's true economic interest in ABACUS, especially once it was put on notice that ACA was acting on the erroneous belief based on Goldman Sachs' affirmative misrepresentations, that Paulson had pre-committed to take a long position in ABACUS. AC, ¶ 44.

In January 2007, Paulson initiated the portfolio selection process by providing Goldman Sachs with its selection criteria. AC, ¶ 50. On January 9, 2007, Goldman Sachs sent ACAM an e-mail regarding the "Paulson Portfolio" attaching a list of 123 RMBS to be considered for inclusion in the reference portfolio. AC, ¶ 51.

On January 22, 2007, ACAM sent an e-mail to Goldman Sachs regarding the "Paulson Portfolio," identifying "86 subprime mortgage positions that [ACAM] would recommend taking exposure to synthetically," including 55 of those "originally submitted to [ACAM] for review." AC, ¶ 52.

On February 2, 2007, Goldman Sachs, Paulson and ACAM representatives met at ACA's offices to discuss RMBS to be included in the reference portfolio. While sitting in the meeting, Fabrice Tourre, a Vice President of Goldman Sachs's Structured Products Correlation Trading Desk, the Goldman Sachs Group responsible for underwriting synthetic CDOs such as ABACUS (the "Desk"), sent an e-mail to a Goldman Sachs colleague, stating, "I am at this ACA Paulson meeting, this is surreal." What he meant by "surreal", according to plaintiff, was that at the meeting, Paulson proposed RMBS, ostensibly in a good faith effort to select those that it considered least likely to default, when in fact - as Goldman Sachs was acutely aware and ACAM did not know - Paulson was proposing RMBS that it considered *most* likely to default. AC, ¶53.

By e-mail dated February 6, 2007, Paulson circulated a "final portfolio" of 90 RMBS to ACAM and Goldman Sachs. The final portfolio contained 49 RMBS originally proposed by Paulson - more than enough to ensure that Paulson (as the ultimate and undisclosed protection buyer) would receive enormous contingent payments under any financial guaranty policy referencing the super senior tranche of ABACUS. AC, ¶ 56.

By February 7, 2007, as reflected in a Goldman Sachs e-mail, Goldman Sachs and Paulson were close to finalizing an engagement letter "for the large RMBS CDO ABACUS trade that will help Paulson short senior tranches of a reference portfolio of Baa2 subprime RMBS risk. . . ." Because ABACUS presented "reputational risk" to Goldman Sachs, Goldman Sachs's Mortgage Capital Committee, which included senior-level management, had to review and approve Goldman Sachs's involvement. AC, ¶ 32.

On February 12, 2007, ACA's Commitments Committee met to formally consider ACAM's participation in ABACUS as portfolio selection agent. The memorandum submitted by the ACAM employees communicating with Goldman Sachs concerning ABACUS to the Commitments Committee memorializes ACAM's belief, based on Goldman Sachs's misrepresentations and omissions, that Paulson was the

> *equity investor* [that] wanted to invest in the 0-9% tranche of a static mezzanine ABS CDO

> backed 100% by subprime residential mortgage securities. [emphasis supplied]

At the meeting, as reflected in contemporaneous handwritten notes of a member of the Commitments Committee present at the meeting, the Commitments Committee specifically discussed ACAM's "portfolio selection work with the equity investor." AC, ¶ 46.

On February 23, 2007, Goldman Sachs repeated and confirmed its misrepresentation that Paulson had agreed to be the equity investor in ABACUS. Contemporaneous notes memorializing a telephone conversation between ACA and Goldman Sachs state:

> 2/23 Call w/ [Goldman Sachs] -- *Counterparty motivation* -- reverse inquiry from Paulson who interviewed several collateral management teams -- one being ACA. *Paulson looking 0-10%.* [emphasis supplied].

By "reverse inquiry," Goldman Sachs meant that Paulson had approached Goldman Sachs to propose that it structure and market ABACUS. AC, ¶ 47.

A March 12, 2007 memorandum from the Desk to Goldman Sachs's Mortgage Capital Committee plainly identified Paulson and Paulson's economic interest in ABACUS, stating that "Goldman [was] effectively working an order for Paulson to buy protection on [*i.e.*, short] specific layers of the [ABACUS] capital structure." The March 12 memorandum also expressly disclosed the Goldman Sachs-Paulson CDS, pursuant to which - unknown to ACA and in direct contradiction to Goldman Sachs's representations to ACA that Paulson was the equity investor in ABACUS - Paulson purchased from Goldman Sachs the protection on the reference portfolio that Goldman Sachs had purchased from the SPV, making Paulson the ultimate and undisclosed protection buyer (*i.e.*, the short investor) in ABACUS. Specifically, the March 12 memorandum explained that:

> Goldman's profits come directly from the purchase of credit protection . . . and *simultaneously re-offering of such protection under the same terms for a pre-negotiated premium that will be payable by Paulson.* [emphasis supplied]

AC, ¶ 33.

Nevertheless, the Mortgage Capital Committee authorized Goldman Sachs to structure, underwrite and sell ABACUS. Goldman Sachs also expected to receive an "upfront premium" from Paulson and projected its profit "to be between $15 million and $20 million." AC, ¶ 34.

On or about March 30, 2007, reasonably relying on Goldman Sachs's false representation that Paulson had pre-committed to take a long position on ABACUS - and thus supposedly shared a common economic interest with ACA in selecting reference obligations that would perform - ACA's Senior Credit Committee authorized ACA to issue a financial guaranty policy on the super senior tranche of ABACUS. AC, ¶ 59.

In April 2010, the Securities and Exchange Commission ("SEC") filed a complaint against Goldman Sachs and Tourre based on the ABACUS transaction.

On April 27, 2010, the United States Senate Permanent Subcommittee on Investigations held a hearing "on the role of investment banks in the [United States financial] crisis, using Goldman Sachs as a case study." The Subcommittee made the following findings of fact, among others:

> (2) **Magnifying risk.** Goldman Sachs magnified the impact of toxic mortgages on financial markets by resecuritizing RMBS securities in [CDOs], referencing them in synthetic CDOs, selling the CDO securities to investors. . . .
>
> (5) **Abacus Transaction.** Goldman Sachs . . . did not disclose to the Moody's analyst overseeing the rating of the CDO that a hedge fund client taking a short position in the CDO had helped to select the reference assets, *and also did not disclose that fact to other investors*. [emphasis supplied]

AC, ¶ 60.

Citing ABACUS as a prominent example, the Subcommittee concluded that Goldman Sachs was one of the "self-interested promoters of risky and complicated financial schemes that helped trigger the [financial] crisis." AC, ¶ 67.

The Subcommittee's final report, entitled "Wall Street and the Financial Crisis: Anatomy of a Financial Collapse," concluded that Goldman Sachs had

> allowed a hedge fund, Paulson & Co. Inc., that planned on shorting the CDO, to play a major *but hidden role* in selecting its assets. Goldman marketed Abacus securities to its clients, knowing the CDO was designed to lose value and without disclosing the hedge fund's asset selection role or investment objective to potential investors. Three long investors [including ACA] together lost about $1 billion from their Abacus investments, while the Paulson hedge fund profited by about the same amount. Today, the Abacus securities are worthless. [emphasis supplied]

AC, ¶ 68.

In July 2010, Goldman Sachs settled the civil claims brought against it by the SEC as a result of the ABACUS transaction, agreeing to pay a $550 million fine. The Consent of Goldman Sachs, signed and dated July 14, 2010, provided in paragraph 3 as follows:

> Goldman acknowledges that the marketing materials for the ABACUS 2007-ACI 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. [emphasis supplied]

ACA then commenced this action, asserting in its Amended Complaint three causes of action against Goldman Sachs: fraudulent inducement (first cause of action); fraudulent concealment (second cause of action) and unjust enrichment (third cause of action).

Defendant now moves to dismiss the Amended Complaint pursuant to CPLR 3211(a)(1), (a)(7) and 3016(b).

Discussion

> On a motion to dismiss pursuant to CPLR 3211, the pleading is to be afforded a liberal construction. . . . We accept the facts as alleged in the complaint as true, accord plaintiffs the benefit of every favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory. Under CPLR 3211(a)(1), a dismissal is warranted only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law. In assessing a motion under CPLR 3211(a)(7), however, a court may freely consider affidavits submitted by the plaintiff to remedy any defects in the complaint and the criterion is whether the proponent of the pleading has a cause of action, not whether he has stated one.

Leon v Martinez, 84 NY2d 83, 88 (1994) (internal citations and quotation marks omitted).

Additionally, CPLR 3016(b) provides that "[w]here a cause of action . . . is based upon misrepresentation, [or] fraud, . . . the circumstances constituting the wrong shall be stated in detail."

That requirement, however, "should not be confused with unassailable proof of fraud . . . section 3016(b) may be met when the facts are sufficient to permit a reasonable inference of the alleged conduct." *Pludeman v Northern Leasing Sys., Inc.*, 10 NY3d 486, 492 (2008).

I. *Fraud Causes of Action*

To properly plead a common-law fraud claim, a plaintiff must allege a misrepresentation of a material fact, falsity of the misrepresentation, scienter, plaintiff's reliance on the alleged misrepresentation and injury resulting from the reliance. *Small v Lorillard Tobacco Co.*, 94 NY2d 43, 57 (1999); *see also P.T. Bank Cent. Asia, N.Y. Branch v ABN AMRO Bank N.V.*, 301 AD2d 375, 376 (1st Dep't 2003). "In addition to the traditional elements of misrepresentation, scienter, reliance and damages, a plaintiff alleging fraud based upon fraudulent concealment must [also] allege a duty to disclose material information. The duty must be based upon some special relationship between the parties." *Albion Alliance Mezzanine Fund, L.P. v State Street Bank and Trust Co.*, 8 Misc3d 264, 269 (Sup Ct, NY Co 2003), *aff'd* 2 AD3d 162 (1st Dep't 2003).

Defendant argues that ACA's Amended Complaint fails to plead a misrepresentation of a material fact; that ACA did not justifiably rely on any alleged misrepresentations; that ACA failed to plead scienter adequately; that ACA's fraudulent concealment claim must fail because the Amended Complaint does not plead a duty to disclose, and that the Amended Complaint does not adequately plead loss causation.

A. *Material Misrepresentation*

According to defendant, ACA bases its allegations that Goldman Sachs misrepresented Paulson's position in ABACUS on statements by it that do not mention Paulson's intended position, and further asserts that every statement on which ACA relies requires substantial, unwarranted inferences to reach the conclusions ACA draws in its Amended Complaint.

Defendant also argues that the only purported basis for any "concealment" by Goldman Sachs is its alleged failure to respond to statements in two e-mails in which ACA speculated about Paulson's positions. However, according to Goldman Sachs, "[m]ere silence may not amount to a concealment actionable as fraud unless done within the context of a fiduciary or confidential relationship." *DH Cattle Holdings Co. v Smith*, 195 AD2d 202, 208 (1st Dep't 2004).

Further, defendant asserts that these e-mails predated the ABACUS closing by months, and thus ACA had plenty of time to ask

Paulson directly what its position was or to review the February 26, 2007 Preliminary Term Sheet, or the ABACUS Offering Circular which both made clear that no one was investing in the equity tranche. Additionally, defendant points to ACA's own Form 10-Q filing for the second quarter of 2007 which disclosed that $192 million of ABACUS notes had been sold to investors, and that those notes were rated "Investment Grade" and were not the unrated "first loss" notes.

Finally, on this issue, defendant asserts that the Amended Complaint contains no allegations demonstrating how ACA's purported inferences about Paulson were material. According to Goldman Sachs, ACA's theory comes down to the proposition that despite its own selection of the reference portfolio and its decision to invest based on the fundamentals of that portfolio, the identity of the short investor was, nonetheless, somehow material to ACA's investment decision. Again, defendant argues that if it was so important, ACA could have just asked Paulson about its position in ABACUS, given that it concededly had direct access to Paulson.

Plaintiff makes reference to the January 10, 2007 e-mail from Goldman Sachs (Fabrice Tourre) which purports to provide a "Transaction Summary" to ACA, in which Paulson is described as the "Transaction Sponsor" with a pre-committed position in ABACUS's equity tranche. The Court in the SEC case found that this e-mail "sufficiently alleges a material misrepresentation regarding Paulson's investment interest." *SEC v Goldman Sachs & Co.*, 790 FSupp2d 147, 162 (SDNY 2011) (Barbara S. Jones, J.). However, defendant argues that this e-mail does not disclose Paulson's position strategy, but rather says only that the capital structure included a "[0]% - [9]% pre-committed first loss" tranche and that Paulson was the "Transaction Sponsor". Based on this, defendant contends that ACA *inferred* that Paulson had pre-committed to acquire the first-loss portion of the capital structure, but never asked Paulson or Goldman Sachs to confirm that inference.

However, the Amended Complaint also alleges that Goldman Sachs affirmatively misrepresented to ACA that Paulson and ACA "shared a common interest" in ABACUS and misrepresented to ACA in its January 10th e-mail that the economic interests of Paulson and ACA were aligned. AC, ¶ 41. Since Goldman Sachs knew that, in fact, the economic interests of ACA and Paulson were in direct conflict, these allegations constitute misrepresentation.

The Complaint here also pleads that Paulson's economic interest in ABACUS was material to ACA's decision to enter into the Financial Guaranty, alleging that

> [h]ad ACA known that Paulson, which played an influential role in selecting the reference

> portfolio, did not have a long position in ABACUS but instead was the sole short investor, ACA would not have agreed to enter into a financial guaranty policy referencing the super senior tranche of ABACUS. Among other things, knowledge of Paulson's true economic interests would have raised a red flag and caused senior ACA personnel to decline to approve any participation in the transaction.

AC, ¶ 63.

ACA also alleges that two other potential participants in ABACUS (i.e., Bear Stearns and GSC) had declined to participate when they were advised that Paulson intended to short the reference portfolio. AC, ¶¶ 30, 37. It appears to this Court that ACA has sufficiently alleged that knowledge of Paulson's true economic interest in ABACUS would have materially affected its decision as to whether to participate in the ABACUS transaction at all. "['A fact may not be dismissed as immaterial unless it is "so obviously unimportant . . . that reasonable minds could not differ on the question of (its) importance" . . . .']" *Swersky v Dreyer & Traub*, 219 AD2d 321, 328 (1st Dep't 1996), *rearg den* 232 AD2d 968 (1st Dep't 1996), *app wdn* 89 NY2d 983 (1997). That is not the case here.

B. *Justifiable Reliance*

Goldman Sachs next argues that ACA fails to adequately plead justifiable reliance. "In assessing the reasonableness of a plaintiff's alleged reliance, [courts] consider the entire context of the transaction, including factors such as its complexity and magnitude, the sophistication of the parties, and the content of any agreements between them." *Emergent Capital Inv. Management, LLC v Stonepath Group, Inc.*, 343 F2d 189, 195 (2nd Cir. 2003). Defendant asserts that ACA's *ex post facto* assertions of blind reliance defy logic in light of ACA's specific disclaimer in an arm's length commercial transaction; its sophistication, experience and sole authority to select the reference portfolio; and its free and direct access to Paulson.

As a threshold matter, Goldman Sachs argues that ACA cannot reasonably have relied on an alleged misrepresentation when a signed contract disclaims reliance, and the facts regarding the allegedly misrepresented information were "readily accessible to any interested party who cared to make inquiry"; not "peculiarly within" the knowledge of the declarant. *Dallas Aerospace, Inc. v CIS Air Corp.*, 352 F3d 775, 785-86 (2nd Cir. 2003). Goldman Sachs points to the ABACUS Offering Circular which it claims contained explicit disclaimers of reliance and refers to a recent case in which the Appellate Division, First Department held that disclosures nearly identical to those included in the ABACUS Offering Circular barred claims asserted by MBIA Insurance Corp. in a similar case against another broker-dealer. *MBIA Ins. Corp. v Merrill Lynch*, 81 AD3d 419 (1st Dep't 2011).

Plaintiff, on the other hand, argues in the first instance that Goldman Sachs has already acknowledged in connection with its settlement with the SEC, that "the marketing materials for the ABACUS 2007-ACI transaction contained incomplete information" and that they failed to disclose that "Paulson's economic interests were adverse to CDO investors." Consent of Defendant Goldman, Sachs & Co., ¶ 3.

Moreover, plaintiff contends that the disclaimers in the Offering Circular have no impact on ACA here because they pertain solely to the notes and ACA no longer has any note-based claims.[2]

In any event, plaintiff claims that for a disclaimer to be effective, it must be "specifically applicable to the alleged misrepresentation at issue." *Silver Oak Capital L.L.C. v UBS AG*, 82 AD3d 666, 667 (1st Dep't 2011) ("general disclaimers contained in the private placement memorandum" were not sufficient). A "disclaimer is generally enforceable only if it 'tracks the substance of the alleged misrepresentation . . . .'" *Caiola v Citibank, N.A.*, 295 F3d 312, 330 (2nd Cir. 2002) (quoting *Grumman Allied Industries, Inc. v Rohr Industries, Inc.*, 748 F2d 729, 735 [2nd Cir. 1984]). Here, the boilerplate disclaimers in the Offering

[2] ACA amended its original Complaint to omit its note-based claims.

Circular cited by Goldman Sachs in its Memorandum of Law at page 17, namely, that the prospective investors should "ensure that they have sufficient knowledge, experience and access to professional advisors to make their own . . . evaluation of the merits and risks of [the] investment" and not base their decision "upon any view expressed by [Goldman Sachs]" do not go to the specific misrepresentation alleged here, namely, that Goldman Sachs misrepresented the role that its hedge fund client, Paulson, was playing in this transaction.

Even if this Court were to find that the disclaimer relied on was sufficiently specific, "a purchaser may not be precluded from claiming reliance on misrepresentations of fact peculiarly within the seller's knowledge, notwithstanding the execution of a specific disclaimer." *Steinhardt Group Inc. v Citicorp*, 272 AD2d 255, 257 (1st Dep't 2000).

Goldman Sachs contends, however, that knowledge of Paulson's role in the transaction was not uniquely in its possession.

> [I]f the facts represented are not matters peculiarly within the party's knowledge, and the other party has the means available to him of knowing, by the exercise of ordinary intelligence, the truth or the real quality of the subject of the representation, he must make use of those means, or he will not be heard to complain that he was induced to enter into the transaction by misrepresentations.

Centro Empresarial Cempresa S.A. v América Móvil, S.A.B. de C.V., 17 NY3d 269, 278-279 (2011) (internal quotation marks and brackets omitted); *see also Danaan Realty Corp. v Harris*, 5 NY2d 317, 322 (1959). "Where sophisticated businessmen engaged in major transactions enjoy access to critical information but fail to take advantage of that access, New York courts are particularly disinclined to entertain claims of justifiable reliance." *Grumman Allied Industries, Inc. v Rohr Industries, Inc.*, 748 F2d at 737; *see also UST Private Equity Invs. Fund v Salomon Smith Barney*, 288 AD2d 87, 88 (1st Dep't 2001).

During oral argument held on the record on October 25, 2011, Goldman Sachs argued that the case closest to this case on the "special knowledge" issue is *Global Minerals and Metals Corp. v Holme*, 35 AD3d 93, 99 (1st Dep't 2006), *lv den* 8 NY3d 804 (2007), where the Appellate Division affirmed the trial Court's granting of summary judgment finding that "no triable issue exist[ed] with respect to [plaintiff's] claim for fraudulent inducement since the evidence establishe[d] that its reliance on any such alleged misrepresentations was unreasonable, and that [plaintiff] failed to fulfill its duty to investigate." The Court further found that

> New York law imposes an affirmative duty on sophisticated investors to protect themselves from misrepresentations made during business acquisitions by investigating the details of the transactions and the business they are acquiring. *See e.g., Abrahami v UPS Constr.*

> *Co., Inc.*, 224 AD2d 231, 234 . . . (1st Dep't 1996) (sophisticated businessmen had a duty to exercise ordinary intelligence and conduct an independent appraisal of the risk they were assuming.)

Global Minerals, 35 AD3d at 100.

Goldman Sachs contends that ACA's Complaint shows that it interacted directly with Paulson throughout the portfolio process, but nowhere pleads that it asked Paulson directly about the investment position it intended to take in ABACUS. As an astute investor and manager of CDOs, defendant asserts, ACA would have been all the more qualified to detect any trends in the securities Paulson was proposing and question its investment interest if that were a factor. According to defendant, ACA proceeded at its own risk and cannot hold Goldman Sachs liable for what plaintiff now perceives as deficiencies in its pre-investment inquiry. Further, Goldman Sachs argues that it should have occurred to ACA after seeing the Offering Circular which, defendant contends, indicated that the equity wasn't being bought by anybody, that it needed to inquire further.

ACA contends that since the economic interests of ACA and Paulson in the transaction were, contrary to Goldman Sachs's representations, exactly opposite, it is entirely speculative to conclude that Paulson, who had a big stake in its short position in this transaction, would have been any more candid with ACA than was Goldman Sachs. *See Swersky v Dreyer & Traub*, 219 AD2d at 327. Moreover, the Court of Appeals has held that even when the parties are sophisticated business entities, where "a plaintiff has taken reasonable steps to protect itself against deception, it should not be denied recovery merely because hindsight suggests that it might have been possible to detect the fraud when it occurred." *DDJ Management, LLC v Rhone Group L.L.C.*, 15 NY3d 147, 154 (2010). "The question of what constitutes reasonable reliance is always nettlesome because it is so fact intensive." *Id.* at 155 (citing *Schlaifer Nance & Co. v Estate of Warhol*, 119 F3d 91, 98 (2nd Cir. 1997)).

Just a few weeks ago, the Appellate Division, First Department issued its decision in *HSH Nordbank AG v UBS AG,* __AD3d__, 2012 WL 997166 (March 27, 2012). In the *HSH Nordbank* case, the Appellate Division dismissed plaintiff's fraud claim as legally insufficient pursuant to CPLR 3211(a)(1) and (7). Specifically, the Court found that

> HSH - a sophisticated commercial entity - cannot satisfy the element of justifiable reliance, inasmuch as the undisputed documentary evidence establishes that HSH agreed that it was not relying on any advice from UBS; assented to the inherent conflicts of interest that would result from UBS's multiple roles with regard to the reference pool; and was explicitly warned of the risks it was undertaking in this highly leveraged

> and complex transaction. Moreover, the allegations of the amended complaint itself establish that HSH could have uncovered any misrepresentation of the risk of the transaction through the exercise of reasonable due diligence within the means of a financial institution of its size and sophistication.

2012 WL 997166 at *1.

The Appellate Division further determined that,

> [a]ll of the misrepresentations alleged in the amended complaint in support of the fraud claim ultimately relate[d] to the level of risk attached to the securities . . . .
>
> * * *
>
> the core subject of the complained-of representations was the reliability of the credit ratings used to define the permissible composition of the reference pool. The reliability of those ratings was the premise on which the entire deal was sold to HSH. Far from being peculiarly within UBS's knowledge, the reliability of the credit ratings could be tested against the public market's valuation of rated securities.

Id. at *3, *5.

Moreover, the Appellate Division found that

> the transactional documents expressly disclosed the potential for conflicts of interests between UBS and HSH to arise in the course of UBS's management of the reference pool and its other trading activities, and provided that HSH would have no claim against UBS arising from such conduct.
>
> * * *
>
> In view of the specific and detailed disclosures and disclaimers set forth above,

> it was unjustifiable and unreasonable as a matter of law for HSH to place any reliance on UBS's alleged extracontractual representations concerning a contemplated "alignment of interests" between the two parties, or concerning UBS's intended "trading strategy" and "motive and economic interest in the deal."

Id. at *10-11.

In this case, however, plaintiff's fraud claims do not allege that plaintiff was relying on defendant's advice as to the risk of the transaction or the level of risk or reliability of the securities involved. Rather, ACA's Complaint specifically alleges that Goldman Sachs concealed from it that through the Goldman Sachs-Paulson CDS, Paulson had purchased from Goldman Sachs the protection on the reference portfolio that Goldman Sachs had purchased from the SPV, making Paulson the undisclosed protection buyer and short investor in ABACUS. AC, ¶ 25. ACA further alleges that the Goldman Sachs-Paulson CD was not discoverable through any publicly available source of information. *Id.*

Moreover, this case is unique in that there has already been an SEC investigation of this very transaction, in which the United Stated Senate Subcommittee on Investigation concluded that Goldman Sachs had

> allowed [Paulson], that planned on shorting the CDO, to play a major *but hidden role* in selecting its assets. Goldman marketed ABACUS securities to its clients, knowing the CDO was designed to lose value and *without disclosing*

> *[Paulson's] asset selection role or investment objective to potential investors.* [emphasis supplied]

Further, as discussed *supra*, in the Consent signed on July 14, 2010 in conjunction with the settlement of the SEC claims, Goldman Sachs specifically acknowledged that it had made a mistake in failing to disclose Paulson's role in the portfolio selection process and the fact that Paulson's economic interests in the transaction were adverse to the CDO investors (as well as the financial guarantor).

Thus, although ACA was a sophisticated business entity, this Court finds that the facts in this case are distinguishable from those in the *HSH Nordbank* case.

ACA further argues that there was nothing on the face of the January 10th e-mail discussed above or anywhere else which would have alerted ACA to potential fraud. To the contrary, ACA has pled that it was customary in the financial industry for the transaction sponsor to pre-commit to invest in the equity of the transaction (AC, ¶ 21), and according to the allegations in the Complaint, Goldman Sachs "repeated and confirmed its misrepresentation that Paulson had agreed to be the equity investor in ABACUS." AC, ¶ 47.

ACA also alleges that it specifically asked Goldman Sachs how Paulson intended to "participate" in the transaction. AC, ¶ 40. In response, Goldman Sachs made detailed written representations about Paulson's economic interest in the transaction, including affirmatively telling ACA that Paulson had the equity piece in the transaction, which were allegedly false and misleading. AC ¶¶ 41, 43. ACA further contends that Paulson reinforced the false impression that it shared ACAM's economic interest in a strong quality reference portfolio by objecting to certain RMBS as being "too risky." AC, ¶ 55. Based on all the above, and given the detailed allegations throughout the Complaint, this Court finds that it would be premature to dismiss plaintiff's fraud claims for failure to plead justifiable reliance on this pre-answer motion to dismiss.

C. *Scienter*

Goldman Sachs next argues that ACA's fraud claims must also fail because ACA did not articulate any basis for establishing that Goldman Sachs acted with scienter. As defendant sees it, ACA claims that Goldman Sachs went to great lengths to design a transaction that would fail, but then decided to forego any benefit from that opportunity by conveying its lucrative short interest to Paulson for a far smaller $15 million fee. In fact, Goldman Sachs stated in a Press Release dated April 16, 2010 in response to the

SEC Complaint that it took a "substantial long position in the transaction" and lost more than $90 million.

According to Goldman Sachs, plaintiff's "view of the facts defies economic reason, and therefore does not yield a reasonable inference of fraudulent intent." *Atlantic Gypsum Co., Inc. v Lloyds Intern. Corp.*, 753 FSupp 505, 514 (SDNY 1990). Rather, defendant argues, if it had believed that the reference portfolio would fail and had defrauded ACA into taking a long position with respect thereto, it would have kept the short position for itself and avoided any long position, making substantial profits instead of sustaining large losses.

In opposition, ACA refers again to the decision in *SEC v Goldman, Sachs & Co., supra*, in which the Court found that the SEC "sufficiently alleges Tourre [on behalf of Goldman Sachs] made the material misrepresentations and omissions . . . with scienter." 790 FSupp2d at 163. Moreover, since "[p]articipants in a fraud do not affirmatively declare to the world that they are engaged in the perpetration of a fraud[,] [t]he Court of Appeals has stated that an intent to commit fraud is to be divined from surrounding circumstances." *Oster v Kirschner*, 77 AD3d 51, 55-56 (1st Dep't 2010) (citing *Eurycleia Partners, LP v Seward & Kissel, LLP,* 12 NY3d 553 [2009]).

According to ACA, the circumstances alleged in the Complaint and discussed above certainly support the inference that Goldman Sachs knowingly misrepresented Paulson's economic interest in ABACUS in order to induce ACA to participate in the transaction. Far from being "commercially irrational" as defendant assets, Goldman Sachs's agreement to help Paulson short the reference portfolio was part of a carefully considered strategy to "position [Goldman Sachs] to compete more aggressively in the growing market" for similarly structured products "which was a huge and economically profitable market for Goldman Sachs." AC, ¶ 65.

"The element of scienter . . . is, of course, the element most likely to be within the sole knowledge of the defendant and least amenable to direct proof . . . [thus] it should be sufficient that the complaint contains some rational basis for inferring that the alleged misrepresentation was knowingly made." *Houbigant, Inc. v Deloitte & Touche*, 503 AD2d 92, 98 (1st Dep't 2003).

Plaintiff's Complaint here certainly contains a "rational basis" to infer that Goldman Sachs intentionally mislead ACA from its silence in the face of ACA's manifest detrimental reliance on its mistaken belief that Paulson was on the same side of the transaction as it was.

Accordingly, the Court finds that ACA sufficiently alleges the element of scienter in its fraud causes of action.

D. *Duty to Disclose*

Goldman Sachs argues that ACA has also failed to plead the existence of a duty to disclose necessary to allege a claim for fraudulent concealment.

> In business [transactions], an affirmative duty to disclose material information may arise from the need to complete or clarify one party's partial or ambiguous statement, or from a fiduciary or confidential relationship between the parties. Such a duty may also arise . . . where: (1) one party has superior knowledge of certain information; (2) that information is not readily available to the other party; and (3) the first party knows that the second party is acting on the basis of mistaken knowledge.

Banque Arabe et Internationale D'Investissement v Md Nat'l Bank, 57 F3d 146, 155 (2nd Cir. 1995) (internal citations omitted).

Defendant contends that none of these circumstances exists in this case. "A fiduciary relationship does not exist between parties engaged in an arm's length business transaction." *Dembeck v 220 Cent. Park S.*, LLC, 33 AD3d 491, 492 (1st Dep't 2006). Goldman Sachs argues that ACA expressly disclaimed a fiduciary relationship with it in both the Engagement Agreement between the parties and the Offering Circular. Moreover, defendant asserts that there was no information imbalance between Goldman Sachs and ACA, which had both the sole authority to select the reference portfolio and ample access to Paulson to inquire about Paulson's investment position.

ACA argues that it has sufficiently pled that, by undertaking to characterize Paulson's economic interest in ABACUS at all, Goldman Sachs assumed a duty of complete and accurate disclosure. As Judge Jones of the Federal District Court found in her *SEC v Goldman Sachs & Co.* decision:

> 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 . . . had a duty to disclose Paulson had a different investment interest - that it was short. *See Caiola v Citibank, N.A., New York*, 295 F3d 312, 330-31 (2nd Cir. 2002) (explaining that once the defendant "chose to discuss its hedging strategy, it had a duty to be both accurate and complete").

S.E.C. v Goldman Sachs & Co., 790 FSupp2d at 162.

In addition, ACA claims that it has sufficiently pled that Goldman Sachs had a duty to disclose under the "special facts" doctrine, pursuant to which "a duty to disclose arises 'where one party's superior knowledge of essential facts renders a transition without disclosure inherently unfair.' (citation omitted)." *P.T.*

Bank Cent. Asia, 301 AD2d at 378; *see also Swersky v Dreyer & Traub*, *supra* at 328-329.

Goldman Sachs's failure to disclose the truth rendered this transaction "inherently unfair" according to ACA, because ACA believed that Paulson had an economic incentive to select reference obligations that would perform when, in fact, as Goldman Sachs allegedly knew and concealed from ACA, Paulson had an economic incentive to select reference obligations that would default. AC, ¶ 25. The Complaint in this case sufficiently alleges facts throughout that suggest that Goldman Sachs had superior knowledge of Paulson's role in the transaction and knew that ACA was acting on the mistaken belief that Paulson had a "long position," and that this knowledge was not readily available to ACA, so as to make it "inappropriate to determine . . . [whether Goldman Sachs had a duty to disclose] as a matter of law based solely on the allegations in plaintiff's complaint." *P.T. Bank Cent. Asia, supra* at 378.

E. *Loss Causation*

Finally as to the fraud claims, Goldman Sachs argues that ACA has failed to plead loss causation. To establish loss causation, a plaintiff must allege "that the misrepresentations directly caused the loss about which plaintiff complains." *Laub v Foessel*, 297 AD2d 28, 31 (1st Dep't 2002). Although the swap ultimately was unwound at a loss, defendant contends, ACA does not allege that the non-disclosure of Paulson's role in ABACUS caused the reference portfolio to perform poorly. According to Goldman Sachs, it is unquestionable that any portfolio of this type would have been swept up in the meltdown of the subprime market and experienced considerable write downs.

ACA, however, claims that in *Laub v Foessel*, *supra*, the First Department made clear that "[l]oss causation is the fundamental core of the common-law concept of proximate cause. 'An essential element of the plaintiff's cause of action . . . for . . . any . . . tort, is that there be some reasonable connection between the act or omission of the defendant and the damage which the plaintiff has suffered.'" 297 AD2d at 31.

The First Department has recently held that allegations are sufficient to show "loss causation [if] it was foreseeable that [the plaintiff] would suffer losses as a result of relying on [defendant's] alleged misrepresentations . . . ." *MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, 87 AD3d 287, 296 (1st Dep't 2011) (citing *Silver Oak Capital L.L.C. v UBS AG*, 82 AD3d at 667 [loss causation was sufficiently alleged "since it was foreseeable that (plaintiff) would sustain a pecuniary loss as a result of relying on (defendant's) alleged misrepresentations"]); *see also Sterling*

Natl. Bank v Ernst & Young, LLP, 9 Misc 3d 1129[A], *6, (Sup Ct, NY Co 2005).

Here, the Complaint alleges that ACA's losses were a foreseeable result of Goldman Sachs's misrepresentation and concealment of Paulson's economic interest in ABACUS. By misrepresenting Paulson to be the "transaction sponsor," Goldman Sachs enabled Paulson to play an influential role in the portfolio selection process. AC, ¶¶ 50-56, 76. Playing the customary role of a purported transaction sponsor, Paulson "specified the parameters of the collateral to be included in the 'initial reference portfolio; specified the RMBS to be included in the 'initial reference portfolio; proposed additional RMBS to be included in the final reference portfolio; and vetoed specific RMBS that ACA proposed to be included in the final reference portfolio." *Id.* ¶ 24. As Goldman Sachs and Paulson intended from the outset (*id.* ¶¶ 28, 32, 33), Paulson's influential role in selecting the reference portfolio had a direct and adverse impact on the performance of every long position in ABACUS, including the Financial Guaranty. *Id.* ¶ 56; *see also* ¶¶ 73-75. It was, therefore, "foreseeable that [ACA] would suffer losses once it was induced by [Goldman Sachs's] representations" to insure the performance of the reference portfolio. *Sterling Natl. Bank*, 9 Misc3d 1129(A) at *6.

Nor can it be said, on this pre-answer motion to dismiss, "that [ACA's] losses were caused, as a matter of law, by the 2007 housing and credit crisis (*see In re Countrywide Fin. Corp. Sec. Litig.*, 588 FSupp2d 1132, 1174 [C.D. Cal. 2008] [it is the job of the fact finder to determine which losses were proximately caused by misrepresentations and which are due to extrinsic forces])." *MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, 87 AD3d at 296.

Accordingly, that portion of Goldman Sachs's motion seeking to dismiss the first two causes of action for fraudulent inducement and fraudulent concealment are denied.

II. *Unjust Enrichment*

"The theory of unjust enrichment lies as a quasi-contract claim. It is an obligation the law creates in the absence of any agreement." *Goldman v Metro. Life Ins. Co.*, 5 NY3d 561, 572 (2005). However, "[t]he existence of a valid and enforceable written contract governing a particular subject matter ordinarily precludes recovery in quasi contract for events arising out of the same subject matter." *Clark-Fitzpatrick, Inc. v Long Is. R.R. Co.*, 70 NY2d 382, 388 (1987). The parties here dispute whether there are valid and enforceable agreements which govern this particular transaction.

Even if ACA's unjust enrichment claim was not precluded by the existence of any contracts, Goldman Sachs argues, ACA cannot establish the required elements of such a claim, namely, that the defendant was enriched at the plaintiff's expense, and that it is against equity and good conscience to permit the defendant to retain what is sought to be recovered. *Mandarin Trading Ltd v Wilderstein,* 16 NY3d 173, 182 (2011). Goldman Sachs argues that far from being enriched, it conveyed its short position, and more, to Paulson, and lost a substantial sum of money as a result of the ABACUS transaction.

ACA contends that even assuming Goldman Sachs lost money on some aspect of the transaction, whether and how it was enriched by its participation in ABACUS is an issue of fact that is not ripe for adjudication on a motion addressed to the pleadings. *See e.g., Bank of N.Y. v Irwin Int'l. Imports,* 197 AD2d 462 (1st Dep't 1993).

This conclusory allegation, without more, however, fails to establish that "defendant was unjustly enriched at the expense of [this] plaintiff [and] warrant[s] dismissal." *Mandarin Trading Ltd v Wilderstein,* 16 NY3d at 183.

Accordingly, plaintiff's third cause of action for unjust enrichment is dismissed.

Defendant Goldman Sachs has 30 days from entry of this decision to serve its Answer to the remaining two causes of action in the Amended Complaint.

Counsel for both parties are directed to appear for a conference in IA Part 39, 60 Centre Street - Room 208 on June 6, 2012 at 10:00 a.m. to set a discovery schedule.

This constitutes the decision and order of this Court.

Date: April 23, 2012

Barbara R. Kapnick
J.S.C.