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COURT OF APPEALS

STATE OF NEW YORK

ACA FINANCIAL GUARANTY CORP.,

Appellant,

-against-

No. 49

GOLDMAN, SACHS & CO.,

Respondent.

20 Eagle Street
Albany, New York 12207
March 26, 2015

Before:

CHIEF JUDGE JONATHAN LIPPMAN
ASSOCIATE JUDGE SUSAN PHILLIPS READ
ASSOCIATE JUDGE EUGENE F. PIGOTT, JR.
ASSOCIATE JUDGE JENNY RIVERA
ASSOCIATE JUDGE SHEILA ABDUS-SALAAM
ASSOCIATE JUDGE LESLIE E. STEIN
ASSOCIATE JUDGE EUGENE M. FAHEY

Appearances:

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Sara Winkeljohn
Official Court Transcriber

1 CHIEF JUDGE LIPPMAN: We're going to go to
2 number 49.

3 Counsel. You want any rebuttal time,
4 counselor?

5 MR. KASOWITZ: Five minutes, please, Your
6 Honor.

7 CHIEF JUDGE LIPPMAN: Five minutes. You're
8 on. Go ahead.

9 MR. KASOWITZ: Thank you, Your Honor. May
10 it please the court, Marc Kasowitz for plaintiff-
11 appellant ACA Financial Guaranty Corp. Your Honors,
12 the majority's holding below that ACA could not plead
13 justifiable reliance as a matter of law is incorrect.

14 CHIEF JUDGE LIPPMAN: Counsel, tell us
15 about what was disclosed about the situat - - - what
16 - - - what bothers you about this? What - - - what
17 was disclosed and what wasn't? What did we know
18 about what this was all about in terms of what
19 Goldman was telling you or, you know, what you were
20 hearing about it.

21 MR. KASOWITZ: Of course, Your Honor. What
22 was not disclosed, Your Honor, was the essential fact
23 that Mr. Paulson and Paulson & Co., which had had the
24 primary role in selecting the securities to be
25 included within this pool, the ABACUS pool - - -

1 CHIEF JUDGE LIPPMAN: Right.

2 MR. KASOWITZ: - - - had rep - - - it had
3 been represented to ACA that Mr. Paulson was long the
4 transaction, that he was betting for this ABACUS CEO
5 to succeed.

6 CHIEF JUDGE LIPPMAN: What - - - how - - -
7 how was it told to - - - how was it told to you,
8 counsel?

9 MR. KASOWITZ: It was told to us in a
10 number of different ways. First, it was told to us
11 that he was sponsoring the transaction, and it's
12 customary for a party that is sponsoring the
13 transaction in this circumstance to be long.
14 Secondly, Goldman had disclosed on a number of
15 different occasions that Paulson was long the
16 transaction, that they were the equity sponsor and
17 that they were long the transaction.

18 CHIEF JUDGE LIPPMAN: What did the circular
19 tell you?

20 MR. KASOWITZ: The circular didn't tell us
21 anything about whether or not - - - whether or not
22 Paulson was long, because the circular related only
23 to the question of whether or not there were notes
24 held in the various tranches.

25 JUDGE READ: I don't think Goldman disputes

1 that anymore. Do they?

2 MR. KASOWITZ: Oh. Oh, they do.

3 JUDGE READ: They do? Okay.

4 MR. KASOWITZ: Oh, they do. And - - - and
5 the - - - and the circular very clearly, in the - - -
6 it - - - in - - - in several different respects,
7 first of all the - - - page - - - at 325 of the
8 record, and this is the - - - and this is the section
9 that Goldman points to, at 325 of the record where
10 you talk about the - - - the first loss, Goldman
11 takes the position here, as they took the position in
12 the SEC/Tourre case, which I'll talk about in a
13 second, that FL - - - that beneath FL there was a
14 zero dollars. And so Goldman's argument is that that
15 zero dollars had ACA on notice that Paulson was not
16 long the transaction.

17 CHIEF JUDGE LIPPMAN: Could you have any
18 way of knowing? Could you have known in any way what
19 was going on here? Did you have reason to believe
20 that - - - that there was anything afoot that was not
21 exactly appropriate?

22 MR. KASOWITZ: Absolutely not, Your Honor.
23 Hasn't - - - hasn't - - -

24 JUDGE READ: What about the - - - what
25 about the meeting?

1 JUDGE RIVERA: But what - - - what does
2 zero reveal?

3 JUDGE READ: Whoop.

4 JUDGE RIVERA: Sorry. No go ahead.

5 JUDGE READ: What about the - - -

6 CHIEF JUDGE LIPPMAN: Judge Read.

7 JUDGE READ: What - - - what about the
8 meeting that you had and afterwards you said to
9 Goldman we - - - basically, we can't figure where
10 Paulson's coming from; will you help us out here?
11 Didn't that show that you weren't exactly sure what
12 his role was in this?

13 MR. KASOWITZ: We asked a legitimate - - -
14 we asked a legitimate question. I don't think that
15 we said we can't figure out where Paulson's coming
16 from. I think what we asked was what is Paulson's
17 role in the transaction, which is - - -

18 JUDGE ABDUS-SALAAM: Why didn't you ever
19 ask Paulson that?

20 MR. KASOWITZ: Excuse me?

21 JUDGE ABDUS-SALAAM: Why didn't you ever
22 ask Paulson what Paulson's role was in the
23 transaction?

24 MR. KASOWITZ: We were having ongoing
25 discussions with Goldman, and the discussions with

1 Goldman were all consistent. They were all
2 consistent with the offering circular and with the
3 memoranda and with the telephone calls. We have a
4 taped telephone - - -

5 JUDGE ABDUS-SALAAM: So that's the reason -
6 - -

7 MR. KASOWITZ: We have a telephone call
8 here.

9 JUDGE ABDUS-SALAAM: - - - you didn't ask
10 Paulson what Paulson's position was, because you were
11 having ongoing discussions with Goldman? Were you
12 prevented from asking Paulson what their position
13 was?

14 MR. KASOWITZ: I don't think we were, Your
15 Honor, prevented from asking Paulson. But I don't
16 think that there was any need to ask Paulson at the
17 same time.

18 CHIEF JUDGE LIPPMAN: Were you relying on
19 Goldman; is that the bottom line? You were relying
20 on Goldman Sachs to - - - they were the people you
21 were dealing with, and that was your first focus in
22 terms of they were putting this together with you?

23 MR. KASOWITZ: That's correct. We were the
24 one - - - Goldman was the ones who had approached us
25 in the first instance. And the allegations are very

1 clear in the complaint - - -

2 JUDGE RIVERA: But is it - - - is it

3 customary to rely on - - -

4 MR. KASOWITZ: Excuse me?

5 JUDGE RIVERA: Is it customary to rely on -

6 - - on someone's who's playing the role that Goldman

7 played?

8 MR. KASOWITZ: Of course. The - - - in the

9 - - -

10 JUDGE RIVERA: Without asking someone like

11 Paulson and the role that he's in.

12 MR. KASOWITZ: But we did - - - we did due

13 diligence that was appropriate at the time.

14 JUDGE RIVERA: The time.

15 MR. KASOWITZ: We were not on - - - the - -

16 - the law is very clear that to be on - - - to be - -

17 - have a - - - a heightened level of scrutiny, to be

18 at inquiry notice, then we have to have actual

19 knowledge that there's fraud.

20 CHIEF JUDGE LIPPMAN: What about - - -

21 MR. KASOWITZ: There was absolutely no

22 knowledge here - - -

23 CHIEF JUDGE LIPPMAN: Talk about - - -

24 MR. KASOWITZ: - - - to that effect.

25 CHIEF JUDGE LIPPMAN: - - - Centro

1 Empresarial, how that fits in in terms of due
2 diligence.

3 MR. KASOWITZ: Well, it's - - - it's - - -
4 it's - - - it's very clear. It's a - - - it's a - -
5 - it's a case that the majority appeared to rely on
6 in looking for and in - - - in trying to justify the
7 need for one of these - - - one of these affirmative
8 - - -

9 JUDGE FAHEY: Prophylactic - - -
10 prophylactic provision.

11 MR. KASOWITZ: Prophyl - - - yeah, so-
12 called prophylactic provisions. But, in fact, in
13 that case there was - - - there was a scrutiny by the
14 court not only of a prophylactic provision, but there
15 was also scrutiny with respect to due diligence that
16 was done.

17 JUDGE FAHEY: Let me ask you this. Let's
18 just stay on that point for a second. You've done an
19 enormous number of bond insurance cases. Is there
20 any case or any - - - is there anywhere in the record
21 or - - - or any case law that you can point us to
22 that a prophylactic provision would be required in
23 this form of a - - - of a bond insuring transaction?
24 Ever - - - has it ever been done? Has it - - - has
25 it ever been inserted? Because I didn't see it.

1 MR. KASOWITZ: In fact - - -

2 JUDGE FAHEY: In other words, the Centro
3 standard rose out of a lease - - - a release, I'm
4 sorry, not a - - - not a lease; out of a release.
5 This - - - this situation, of course, is much
6 different so - - -

7 MR. KASOWITZ: It - - - it's completely
8 different, Your Honor, because at the core there was
9 no contract betw - - -

10 JUDGE FAHEY: So in the industry, is it a
11 practice to ever insert a prophylactic provision in
12 this form of a transaction?

13 MR. KASOWITZ: No.

14 JUDGE ABDUS-SALAAM: Counsel - - -

15 JUDGE FAHEY: Definitively no.

16 MR. KASOWITZ: Not in this circumstance
17 where there isn't a contract.

18 JUDGE FAHEY: Okay.

19 MR. KASOWITZ: We had no - - - ACA had not
20 purchased any notes from Goldman. That was - - -
21 that's an undisputed fact. So where there was no
22 contract, the majority's reference to the fact that
23 there should have been included a prophylactic - - -
24 a prophylactic provision within a contract, which did
25 not exist in this circumstance - - -

1 JUDGE STEIN: And no requirement to sep - -
2 -

3 MR. KASOWITZ: - - - made no sense. I'm
4 sorry.

5 JUDGE STEIN: No requirement to enter into
6 a - - - a separate agreement solely for that purpose?

7 MR. KASOWITZ: Absolutely not.

8 JUDGE READ: But you could have?

9 MR. KASOWITZ: Anything could happen, Your
10 Honor.

11 JUDGE READ: Yeah. Well - - -

12 MR. KASOWITZ: But in these circumstances
13 it's customary not to have an agreement in those
14 circumstances.

15 JUDGE READ: You're saying that due
16 diligence didn't require you to do something like
17 that.

18 MR. KASOWITZ: Nothing required us to enter
19 into a contract with Goldman in those circumstances.

20 JUDGE RIVERA: Because it's the nature of
21 these transactions is what you're saying.

22 MR. KASOWITZ: Yes. That's correct. We
23 had - - -

24 JUDGE RIVERA: Can I just ask - - - ask - -
25 - I know you say that on the circular the FL zero,

1 the column FL with the zero dollars next to it,
2 doesn't put you on notice as to anything regarding
3 Paulson.

4 MR. KASOWITZ: Sure.

5 JUDGE RIVERA: What does it put you on
6 notice of? Does it put on notice of anything?

7 MR. KASOWITZ: No.

8 JUDGE RIVERA: What meaning does - - - do
9 these rows - - - does the rows across of zeros have?

10 MR. KASOWITZ: These - - - these all relate
11 to - - - it all relates to notes. If you look at the
12 first one, the super sec - - - the - - - the super
13 senior notes - - -

14 JUDGE RIVERA: Um-hum.

15 MR. KASOWITZ: - - - ACA was providing a -
16 - - a - - - wrap, an insurance product, for - - -
17 through a credit default swap for those super senior
18 notes, a credit default swap. That was a zero, as
19 well.

20 JUDGE STEIN: Is that customary, as well?

21 MR. KASOWITZ: So there was no surprise.
22 There was - - - I'm sorry, Your Honor.

23 JUDGE STEIN: Is that also customary?

24 MR. KASOWITZ: Yes.

25 JUDGE STEIN: Then so - - - so it wouldn't

1 - - - when you saw a zero in the column in which you
2 would otherwise be, it didn't - - - it wouldn't not
3 lead you to ask well, why - - - how - - - why isn't
4 our interest shown here?

5 MR. KASOWITZ: Just the opposite, Your
6 Honor.

7 JUDGE RIVERA: It's not a red flag?

8 MR. KASOWITZ: When we saw the zero - - -
9 when we saw the zero under the first loss, that
10 didn't surprise us, because there was a zero under
11 the super secure - - - the super senior, and we know
12 that we had wrapped the super senior. We were told -
13 - - we were told that Paulson had wrapped the first
14 loss.

15 JUDGE ABDUS-SALAAM: Go - - - going back to
16 some things that might have raised red flags for you
17 about Paulson's position, your company allowed
18 Paulson to select the products that were going into
19 this offering, correct?

20 MR. KASOWITZ: In - - -

21 JUDGE ABDUS-SALAAM: Is that - - - they - -
22 - they were able to select the reference?

23 MR. KASOWITZ: Yes. That's correct, Your
24 Honor.

25 JUDGE ABDUS-SALAAM: And when they did

1 select the ones that appeared to be losers, did that
2 not raise some kind of red flag to ask them what
3 their position was?

4 MR. KASOWITZ: No, Your Honor. And these
5 allegations in the complaint are clear, because in
6 the first instance Paulson was the party that was
7 expert in this area. We had understood that they
8 were long the transaction. And there are allegations
9 in the complaint which reflect the fact that there
10 were certain circumstances in which Paulson's
11 representatives in these meetings will say oh, well,
12 we're not going to pick this one, because it looks
13 like it won't live up to our standards, that sort of
14 thing.

15 JUDGE ABDUS-SALAAM: Did Paulson - - -

16 MR. KASOWITZ: So there was concealment all
17 the way through, Your Honor.

18 JUDGE ABDUS-SALAAM: Well, did - - - did
19 Paulson ever push this product at all? You know, if
20 they were so - - - if they were such proud investors
21 in it, don't you think they would have advertised it
22 so they could attract other investors to - - -

23 MR. KASOWITZ: That - - -

24 JUDGE ABDUS-SALAAM: - - - invest in it - -

25 -

1 MR. KASOWITZ: That - - -

2 JUDGE ABDUS-SALAAM: - - - with their
3 reputation? Wasn't that the point that if they were
4 going to be equity investors that they would want
5 other people to invest in it, and they would be
6 touting their - - - their participation in it?

7 MR. KASOWITZ: Absolutely not, Your Honor.
8 This - - - as - - - as the - - - as the complaint
9 makes very, very clear, this was all part of a plan
10 by Paulson in order to cash in to the tune of a
11 billion dollars on its view that the subprime market
12 was going south and that it could, according to a
13 number of criteria, select a number of securities and
14 mortgages to include within a pool for this - - - for
15 this - - - for this CDO, to include within a pool for
16 this CDO ones that would fail. He wasn't - - -
17 Paulson wasn't interested in other people.

18 JUDGE FAHEY: Well, he was - - - give him -
19 - - give him credit.

20 MR. KASOWITZ: They were interested in
21 their billion dollars.

22 JUDGE FAHEY: Give him credit. They were
23 right. So - - -

24 MR. KASOWITZ: And they were right.

25 JUDGE FAHEY: Yeah. They were right. So -

1 - -

2 MR. KASOWITZ: But they lied.

3 JUDGE FAHEY: So this - - - well, the
4 question is was the big short, which is what we're
5 talking about here, was - - - was the big short
6 fraudulently obtained.

7 MR. KASOWITZ: This one was, Your Honor.
8 This one was, Your Honor. That's - - - that's
9 exactly what the - - - what the SEC case against Mr.
10 Toure was about. The finding by the jury was that
11 it was fraud. The finding by the jury was was that
12 that circular, that - - - that offering circular did
13 not put ACI - - - ACA on notice that there was any
14 fraud.

15 CHIEF JUDGE LIPPMAN: Thanks, counselor.

16 MR. KASOWITZ: Thank you, Your Honor.

17 CHIEF JUDGE LIPPMAN: You'll have your
18 rebuttal. Let's hear from the other side.

19 MR. KASOWITZ: Thank you, Your Honor.

20 MR. KLAPPER: Good afternoon, Your Honors;
21 Richard Klapper for the appellee Goldman Sachs & Co.

22 CHIEF JUDGE LIPPMAN: Counsel, do you - - -
23 do you feel that you dealt on the up and up with - -
24 - with your adversary corporation?

25 MR. KLAPPER: Well, Goldman Sachs has

1 admitted - - -

2 CHIEF JUDGE LIPPMAN: You acknowledge that
3 you did not - - -

4 MR. KLAPPER: - - - that we - - - we made -
5 - -

6 CHIEF JUDGE LIPPMAN: - - - do what you
7 should be doing, right?

8 MR. KLAPPER: No, Goldman Sachs
9 acknowledged it made a mistake. That's what it
10 acknowledged in its SEC settlement, the mistake being
11 not disclosing - - -

12 CHIEF JUDGE LIPPMAN: Why should they
13 suffer because of a mistake that you made in relation
14 - - - in your dealings with them?

15 MR. KLAPPER: Because they did not
16 reasonably rely on anything Goldman Sachs told them.

17 JUDGE PIGOTT: How - - - how does that
18 become - - - how does that become a matter of law? I
19 mean what - - - it - - - it sounds like a penultimate
20 question of fact to me whether they reasonably
21 relied, you know, on the representations that Tourre
22 made.

23 MR. KLAPPER: Because under the cases in
24 this court starting back in 1892 with the Schumaker
25 case, a party, any party, who has the means with the

1 exercise of ordinary intelligence to find out what -
2 - -

3 CHIEF JUDGE LIPPMAN: What signals did they
4 have that - - - that should have alerted them to the
5 fact that there's something here that - - - that's
6 wrong?

7 MR. KLAPPER: Well - - -

8 CHIEF JUDGE LIPPMAN: What were the signals
9 that would - - - a reasonable person, in your mind,
10 or using reasonable logic would know that you were
11 deceiving them about the role of Paulson?

12 MR. KLAPPER: First off, Schumaker doesn't
13 require any kind of signal. It requires prudence and
14 the exercise of ordinary intelligence.

15 JUDGE PIGOTT: But there's a difference
16 when it's - - - when there's intentional acts. In
17 other words, if - - - if - - - if you're going to buy
18 fire insurance with the intention of burning down
19 your house, you can't say well, the fire insurance
20 company didn't reasonably rely on the fact that I
21 sent them the premium. I mean you - - - you - - -
22 you set about a goal of doing something to deceive.
23 Then reasonable reliance, it seems to me, it - - - it
24 - - - it's a little bit different when that type of -
25 - - of occurs. Am I right?

1 MR. KLAPPER: Well, let me - - - let me be
2 clear. In the Toure case and otherwise, there was
3 no finding of an intentional misrepresentation or
4 omission.

5 CHIEF JUDGE LIPPMAN: What did - - - what
6 did you do if it wasn't an intentional
7 misrepresentation?

8 MR. KLAPPER: The most that could be taken
9 from the Toure case, which is not something that's
10 collateral estoppel as to Goldman Sachs - - -

11 CHIEF JUDGE LIPPMAN: Go ahead.

12 MR. KLAPPER: - - - which is not a party -
13 - -

14 CHIEF JUDGE LIPPMAN: Go ahead.

15 MR. KLAPPER: - - - the most that can be
16 said about that case is that Mr. Toure either
17 participated in some sort of scheme or negligently
18 failed to make something clear that was material.

19 JUDGE PIGOTT: Aren't those questions of
20 fact? That - - - that - - - I - - - I hate to sound
21 like a broken record here, but you're right. I mean,
22 everybody says well, it wasn't any finding
23 specifically. But - - - but Toure on - - - in
24 January 10th, e-mailed and said that Paulson's pre-
25 committed to taking a long position.

1 MR. KLAPPER: That's - - -

2 JUDGE PIGOTT: Now, it would seem to me
3 that that may raise an issue of fact with respect to
4 they - - - to - - - to what they're relying on and
5 whether it was reasonable.

6 MR. KLAPPER: Let me address that - - -

7 JUDGE PIGOTT: Okay.

8 MR. KLAPPER: - - - specifically. Because
9 ACA and my friend, Mr. Kasowitz, say that but if you
10 take a look at the record 730 to 731, which is the
11 e-mail, it says absolutely nothing of the sort. It
12 goes through some features of the deal. It then
13 talks about the capital structure. It says zero to
14 nine percent pre-committed first loss and does not
15 say who, if anybody, was going to purchase that first
16 loss, personally to the pre-commission.

17 JUDGE PIGOTT: And it also said that - - -
18 Toure said that - - - that he admitted that that
19 e-mail was inaccurate.

20 MR. KLAPPER: Yeah, because nobody had pre-
21 committed.

22 JUDGE PIGOTT: Where are we going with
23 this, though? I mean you want summary judgment. You
24 - - - you want - - - you - - - you want to carry the
25 day saying there are no issues of fact, and we're

1 entitled to judgment as a matter of law.

2 MR. KLAPPER: I don't - - - I don't say
3 there are no issues of fact. There are certainly
4 issues of fact. What Mr. Tourre was doing, his
5 intent - - -

6 JUDGE STEIN: Well - - -

7 MR. KLAPPER: - - - all those things are
8 issues of fact. It's the question of issues of fact
9 going to reasonable reliance.

10 JUDGE STEIN: We don't - - - but we don't
11 have a summary judgment motion here even. We're only
12 looking at the pleading, aren't we? I - - - I'm not
13 even sure why - - - why we're talking as if this is a
14 summary judgment motion.

15 MR. KLAPPER: Well, because there are
16 certain things that are uncontested and they require
17 a finding of lack of reasonable reliance. It's
18 uncontested.

19 JUDGE STEIN: Well, but the lack of
20 reasonable reliance goes to - - - doesn't it go to
21 what should or shouldn't have reasonably triggered a
22 certain duty on the part of ACA?

23 MR. KLAPPER: No. Again, if you go back -
24 - - if you go back to the Schumaker case, without any
25 kind of trigger, if you have the means of testing the

1 truth of what you are going to later say was false,
2 you have to make use of those means.

3 CHIEF JUDGE LIPPMAN: How do you - - - so
4 how could they have made use of finding out the
5 truth, the means of - - - of getting to the truth?

6 MR. KLAPPER: They - - -

7 CHIEF JUDGE LIPPMAN: What should they have
8 done which would have told them what the truth is and
9 that there they would be on notice and they'd have to
10 let you off the hook?

11 MR. KLAPPER: Well, they could - - -

12 CHIEF JUDGE LIPPMAN: What - - - what
13 should they have done?

14 MR. KLAPPER: They could have asked for a
15 contractual provision; and remember, the disclaimer
16 in this case says you're relying on what's in the
17 200-page offering circular or any other written
18 agreement.

19 CHIEF JUDGE LIPPMAN: What would the
20 contractual - - -

21 MR. KLAPPER: They could have gotten a
22 written agreement.

23 CHIEF JUDGE LIPPMAN: What would the
24 contractual provision have said?

25 MR. KLAPPER: Well, that's what this court

1 doesn't know and neither do I, because what they say
2 is, well, it should have said Paulson was long.
3 Well, it - - - it's unclear. Paulson long, how much,
4 for how long? And does it really matter whether
5 Paulson's long as opposed to whether Paulson was
6 short.

7 JUDGE PIGOTT: Don't we assume - - - if
8 Judge Stein was right we're talking 3211 where we
9 assume all of the facts in the complaint to be true?

10 MR. KLAPPER: No. They don't allege what
11 they asked for, because they didn't ask for anything.

12 JUDGE PIGOTT: Well, you're suggesting they
13 should have and didn't.

14 MR. KLAPPER: I'm suggesting they don't
15 allege it. Yes.

16 JUDGE ABDUS-SALAAM: That they didn't
17 allege any diligence, let - - - let alone due
18 diligence?

19 MR. KLAPPER: Correct.

20 JUDGE ABDUS-SALAAM: So why would they have
21 had to do a contract? Why wouldn't they - - - they
22 met with Paulson or Paulson representatives directly
23 without Goldman, didn't they?

24 MR. KLAPPER: They did.

25 JUDGE ABDUS-SALAAM: And wouldn't they just

1 have as easily been able to say to that Paulson
2 representative what is your position?

3 MR. KLAPPER: They could have. Yes. They
4 could have asked Mr. Pellegrini of Paulson what is
5 the position you intend to take.

6 CHIEF JUDGE LIPPMAN: What happened when
7 they asked you about Paulson?

8 MR. KLAPPER: The - - - they asked in
9 e-mails on a couple of occasions. One was to say
10 it's hard to figure out what Paulson's position is.
11 And they - - -

12 CHIEF JUDGE LIPPMAN: So what was your
13 answer?

14 MR. KLAPPER: They didn't get a response.
15 They also said in an e-mail later, this is all in
16 January.

17 JUDGE RIVERA: (Sneezes)

18 MR. KLAPPER: Bless you.

19 JUDGE RIVERA: Thank you.

20 MR. KLAPPER: All in January where they
21 said it's hard to determine from Paulson's equity
22 position something or other. So - - -

23 CHIEF JUDGE LIPPMAN: What's your
24 responsibility when they send that kind of an e-mail
25 or that kind of question or inq - - - inquiry? What

1 are you supposed to do?

2 MR. KLAPPER: Well, under the law we're not
3 obligated to say anything. I think under our
4 standards we would expect our people to answer, but
5 under the law they don't have to answer.

6 CHIEF JUDGE LIPPMAN: What about under the
7 standard of fair dealing and appropriate - - - you're
8 - - - you're putting something together. Don't you
9 have an obligation to say something to them?

10 MR. KLAPPER: We - - -

11 CHIEF JUDGE LIPPMAN: Or, by not saying
12 something, you're deliberately misleading them?

13 MR. KLAPPER: We - - - well, it depends if
14 it's mis - - - material. The obligation - - - we
15 don't have an obligation except - - -

16 CHIEF JUDGE LIPPMAN: This is pretty
17 immaterial about what Paulson's role is. Isn't it?

18 MR. KLAPPER: Well, that's unclear. They
19 allege it in some - - -

20 CHIEF JUDGE LIPPMAN: Paulson's role is not
21 important here, what they were doing here?

22 MR. KLAPPER: Well, the - - - the portfolio
23 selection - - -

24 JUDGE RIVERA: Well, why - - - why - - -
25 why would they put money into the thing?

1 MR. KLAPPER: The portfol - - -

2 JUDGE RIVERA: Why would they bet against
3 themselves?

4 MR. KLAPPER: The portfolio selection agent
5 in this transaction was ACA. They were paid a
6 million dollars. They represented themselves as
7 knowing what they were doing to select this
8 portfolio. They worked with Paulson, but Paulson was
9 not the one who had the final decision what went into
10 this deal. It was ACA.

11 JUDGE STEIN: Was there some history here
12 of - - - of you or Paulson not disclosing the - - -
13 the true position and then being rejected by Bear
14 Stearns for - - -

15 MR. KLAPPER: There - - - there is - - -

16 JUDGE STEIN: - - - to take on the role
17 that - - - that ACA eventually did?

18 MR. KLAPPER: There - - - there's an
19 allegation that when - - - when they approached Bear
20 Stearns and told Bear Stearns what Paulson was
21 intending to do, that Bear Stearns said we won't do
22 this deal.

23 JUDGE STEIN: So is - - - is that any
24 possible basis for - - - for ACA to think that, you
25 know, maybe it wouldn't have been productive to ask

1 Paulson?

2 MR. KLAPPER: They didn't know that. They
3 didn't know that at the time. You see, they say
4 today, gee, Paulson would have lied. They don't know
5 a single - - - they didn't know at the time a single
6 one of the facts that they rely on now for the
7 supposition that Paulson - - -

8 JUDGE ABDUS-SALAAM: In fact, they would
9 have had a better case had they asked Paulson and
10 Paulson lied.

11 MR. KLAPPER: Exactly.

12 JUDGE ABDUS-SALAAM: We wouldn't be here,
13 would we?

14 MR. KLAPPER: The purpose - - - the purpose
15 of these rules, which are prophylactic advice,
16 disclaimers, the - - - the Schumaker Rule, the
17 purpose of the rules are to make sure that this court
18 and the parties are not standing in front of you
19 today trying to figure out what was and wasn't
20 important.

21 JUDGE RIVERA: Well, how do - - - how do
22 these transactions usually work? Are these the kinds
23 of questions that are posed? Do - - - and - - - and
24 do you enter these kinds of side agreements you're
25 talking about?

1 MR. KLAPPER: This is an unusual - - -

2 JUDGE RIVERA: Is this - - - I - - - I just
3 want to know if this is unusual or this is the way
4 this industry functioned at that point in time.

5 MR. KLAPPER: This is unusual because
6 normally you don't tell one of your clients what your
7 other client is doing. So you wouldn't - - -

8 JUDGE FAHEY: Let - - - let me just go back
9 to the - - -

10 MR. KLAPPER: Certainly.

11 JUDGE FAHEY: You had made a point before
12 that the complaint was insufficient because the first
13 complaint, I guess the - - - the - - - which the
14 Appellant Division ruled on, didn't even address the
15 diligence question, forgetting about whether or not
16 it was due. I thought there was a second amended
17 complaint, though. Was - - - was - - - and that was
18 answered, and I thought the allegation there was that
19 there was diligence alleged in that.

20 MR. KLAPPER: There was a first amended
21 complaint which the First Department dealt with.
22 That did have allegations about diligence or the lack
23 of it.

24 JUDGE FAHEY: Um-hum.

25 MR. KLAPPER: That's where it's clear that

1 they didn't ask Paulson. They had unfettered access
2 to Paulson. They didn't ask for an agreement.

3 JUDGE FAHEY: Well, on that~~eir~~ complaint I
4 thought the Appellate Division there said basically
5 that the - - - they relied on the offering circular.

6 MR. KLAPPER: Well, one of the things that
7 should have alerted them to the fact that Paulson was
8 not buying a cash equity position was the offering
9 circular very clearly said - - -

10 JUDGE FAHEY: So they relied on the
11 offering circular?

12 MR. KLAPPER: They relied on the offering
13 circular.

14 JUDGE FAHEY: So what about the second
15 amended complaint?

16 MR. KLAPPER: Same thing.

17 JUDGE FAHEY: Um-hum.

18 MR. KLAPPER: The - - - the offering
19 circular made very clear, as did the term sheet from
20 the end of February, that the only notes being
21 purchased, the only securities being purchased in
22 this deal were 192 million dollars' worth of A-1 and
23 A-2 notes, including those purchased by ACA on behalf
24 of its CDOs. It made clear that nobody was purging
25 cash equity.

1 Now, do we say that that proves that
2 Paulson didn't buy equity in any shape or form? No.
3 We say it shows that Paulson was not buying cash
4 equity in that transaction, but that is a big, huge
5 red flag for somebody who claims, before investing
6 909 million dollars - - -

7 JUDGE RIVERA: You - - - so you're saying
8 at the - - - at - - - at the time of - - - of this
9 agreement - - -

10 MR. KLAPPER: Yes.

11 JUDGE RIVERA: - - - that that would have
12 been unusual?

13 MR. KLAPPER: It - - - it - - -

14 JUDGE RIVERA: And you're saying this is
15 not how business was done at the time.

16 MR. KLAPPER: No. I'm - - - I'm saying
17 that it alerted - - -

18 JUDGE RIVERA: Was this how business was
19 done at the time?

20 MR. KLAPPER: Yes. We disclosed who was
21 buying in this deal, and it disclosed nobody buying
22 the equity. But it - - -

23 JUDGE RIVERA: No, no. I understand that.
24 I'm talking about the - - - the cash equity.

25 MR. KLAPPER: The - - -

1 JUDGE RIVERA: Is that how people ran their
2 deals at the time?

3 MR. KLAPPER: This - - - this is a somewhat
4 unusual deal because it's a so-called partial capital
5 structure deal. You only sold part of the capital
6 structure.

7 JUDGE RIVERA: Um-hum.

8 MR. KLAPPER: And, yes, it was not uncommon
9 in this kind of deal that nobody bought the equity.

10 JUDGE RIVERA: So - - - so then how is it a
11 red flag?

12 MR. KLAPPER: It's a red flag because they
13 thought that Pauls - - - they claim that Paulson was
14 buying the equity. If they read this - - - and they
15 contributed to this offering circular; they not only
16 had it, they contributed to it - - -

17 JUDGE RIVERA: So because at that time that
18 would not be unusual. It wouldn't have been a red
19 flag. But because they knew that this particular
20 individual - - -

21 MR. KLAPPER: They allege that it was - - -

22 JUDGE RIVERA: - - - was - - - was doing
23 cash equity, they should have realized, oh, this is
24 telling me he's not, so there must be something
25 wrong.

1 MR. KLAPPER: Right. They allege that it
2 was material to them that Paulson was buying equity.

3 JUDGE RIVERA: Um-hum.

4 MR. KLAPPER: They see a document that says
5 we're not selling equity to anybody in this cash
6 deal. That was a huge red flag. Now, what should -
7 - -

8 JUDGE ABDUS-SALAAM: So - - - so first - -
9 -

10 JUDGE RIVERA: What about the credit swaps?
11 What - - - what - - -

12 MR. KLAPPER: What should they have done?

13 JUDGE RIVERA: What about the credit swaps?

14 MR. KLAPPER: Excuse me?

15 JUDGE RIVERA: No. What about the credit
16 swaps?

17 MR. KLAPPER: Well - - -

18 JUDGE RIVERA: Does that matter at all?

19 MR. KLAPPER: You can do just about
20 anything with credit default swaps in terms of
21 mimicking the economics of the cash deal. What we
22 contend is not that this said they're not investing
23 in the equity in way - - - in any way, shape, or
24 form. It said we're not investing in - - - in the
25 cash equity.

1 JUDGE RIVERA: Um-hum.

2 MR. KLAPPER: And did they ask, well, gee,
3 Paulson, how are you investing in the equity if
4 you're not investing in the cash?

5 JUDGE PIGOTT: Those are all good, but I -
6 - - I mean you can tell we're not experts in this
7 field. And it - - - and it's hard - - - you know,
8 you - - - you say this is obvious, this is a red
9 flag, anybody knows. But they're alleging that it
10 wasn't obvious, that they didn't know, and they keep
11 pointing - - - at least point substantially to
12 Toure. And - - - and he seemed to be kind of an
13 interesting character in this.

14 I was looking at the meeting in '0 - - - in
15 - - - in '07 between ACA and Paulson to discuss the
16 RMBS that were going to be included in the portfolio.
17 And he e-mails a colleague saying this is getting
18 surreal. And they allege that while ACA was picking
19 healthy securities, Paulson was picking ones that
20 were likely to default. Now, is there a question of
21 fact in there or - - - or am I barking up the wrong
22 tree?

23 MR. KLAPPER: Of - - - of - - - of - - -
24 yes, absolutely. There are lots of questions of
25 fact, including what exactly did Mr. Toure say, what

1 did Paulson say, what did ACA say.

2 CHIEF JUDGE LIPPMAN: So why should we end
3 this proceeding now if there are all these questions
4 of fact?

5 MR. KLAPPER: Because the undisputed issues
6 of fact require, under this court's standard,
7 dismissal on the basis of unjustifiable reliance,
8 because DDJ, the Danann Realty case, all these cases
9 say, especially for sophisticated people, if - - - if
10 you find something important, either write it up so
11 everyone knows what's important - - -

12 CHIEF JUDGE LIPPMAN: Even sophisticated
13 people can be deceived, can't they?

14 MR. KLAPPER: Correct. But if - - - if you
15 - - - let's say you did your - - - what you should
16 have done. You wrote it up in a rep or warranty. Or
17 you made some diligence of Paulson. And, you know
18 what, they lied.

19 CHIEF JUDGE LIPPMAN: Yeah. But apropos
20 what Judge - - - apropos what Judge Pigott was
21 saying, you know, you're saying that this, that, and
22 the other thing should have told you and you should
23 have written up this, that, and the other thing. Why
24 is that clear, based on their complaint which makes
25 certain allegations which we have to take as, you

1 know, under a 3211 situation.

2 MR. KLAPPER: It - - - it's - - -

3 CHIEF JUDGE LIPPMAN: Why - - - why is it
4 that - - - that this is so crystal clear that they
5 shouldn't have been able to rely - - - what's the
6 strongest reason why they shouldn't have been able to
7 rely on what they were hearing?

8 MR. KLAPPER: Because the law says they
9 can't.

10 CHIEF JUDGE LIPPMAN: No, no. What
11 specific thing?

12 MR. KLAPPER: Well, I - - - I'm - - - I'm
13 back to the law says they have to write up a rep or
14 warrant. This is DDJ.

15 CHIEF JUDGE LIPPMAN: So - - - so that's
16 the main thing. They have to write it up and then
17 that - - -

18 MR. KLAPPER: Or - - -

19 CHIEF JUDGE LIPPMAN: - - - then they'd be
20 okay?

21 MR. KLAPPER: Or - - -

22 CHIEF JUDGE LIPPMAN: Yeah?

23 MR. KLAPPER: - - - due diligence on the
24 thing that they say is so important to them. And the
25 reason, as a matter of policy, is that you want

1 especially sophisticated people, parties - - - and
2 this is under New York contract law as well as New
3 York tort law - - -

4 CHIEF JUDGE LIPPMAN: How does this approve
5 - - - improve business transactions like this?

6 MR. KLAPPER: It - - -

7 CHIEF JUDGE LIPPMAN: If we find for you,
8 what are we doing to help fair dealing and honest
9 relationships between parties putting together a deal
10 like this?

11 MR. KLAPPER: Well, I - - - I would - - -

12 CHIEF JUDGE LIPPMAN: What do we do from a
13 policy perspective that's - - -

14 MR. KLAPPER: From a - - -

15 CHIEF JUDGE LIPPMAN: - - - good if we find
16 for you?

17 MR. KLAPPER: Okay. From a policy
18 perspective, I'm going to follow Judge then - - - now
19 Justice Alito in the MBIA case where he's
20 interpreting New York law trying to figure out what
21 Delaware law should be. And he says that this is
22 what you should do and what New York law does the way
23 he interprets it. And that is instead of forcing the
24 one party to figure out what the other party thinks
25 is important, he says the safer route is to leave

1 parties that can protect themselves to their own
2 devices in forcing the agreement they actually
3 fashion. This rule will make for less - - - less
4 prolix disclaimers and reduce the risk of fraud by
5 unintentional omission.

6 CHIEF JUDGE LIPPMAN: Okay, counsel.

7 MR. KLAPPER: So what we're forcing is a
8 matter of policy, and I believe New York law
9 currently does it, is sophisticated people, if it's
10 important to me what Paulson's position is, I should
11 write that into my agreement.

12 CHIEF JUDGE LIPPMAN: Okay, counsel. Let's
13 hear from - - - rebuttal from your adversary.

14 MR. KLAPPER: Thank you, Your Honors.

15 CHIEF JUDGE LIPPMAN: Counsel, should have
16 you written this into the agreement? That's his - -
17 - his - - - that's the main thing you should have
18 done, in your adversary's words. Why was that not
19 something that - - - that you would do, did do?

20 MR. KASOWITZ: There wasn't any agreement,
21 Your Honor. There was no agreement.

22 CHIEF JUDGE LIPPMAN: You were at a point
23 where that didn't make an - - -

24 MR. KASOWITZ: There was no purchase of
25 notes.

1 CHIEF JUDGE LIPPMAN: You were at a point
2 where that didn't make any sense. Is that what
3 you're saying?

4 MR. KASOWITZ: There just - - - there was
5 no agreement. There never was an agreement with
6 respect to this issue. There aren't agreements with
7 respect to these credit default swaps. The~~y~~ - - -
8 the - - - the representations were made apart from
9 any particular agreement.

10 CHIEF JUDGE LIPPMAN: Was there anything
11 you could have done at that point, with no agreement,
12 that would show your due diligence?

13 MR. KASOWITZ: Sure. And - - - and we did
14 lots of things to - - - to - - - to show due
15 diligence. We asked questions of the people who
16 brought us into the deal who were Goldman Sachs. You
17 know, this is one of these very interesting
18 situations where we have counsel for Goldman Sachs
19 telling us here, telling this court, that it was
20 unreasonable as a matter of law for our client to
21 have relied on what their client was telling them.
22 Really?

23 JUDGE FAHEY: Well, what they're saying is
24 that you didn't do any diligence, that you didn't
25 allege any diligence at all. And what you're saying

1 is there - - - there were a num - - - there were the
2 e-mails, there were a number of things that happened
3 that at least create a question of fact as to this.
4 And we alleged enough to get over the burden there.

5 This all comes down to two things. The
6 difference between the SEC standard and the New York
7 standard, and wheth - - - and how - - - whether
8 reliance applies, which it does and then if it
9 applies, whether or not you properly alleged it, and
10 then, of course, in the same vein, whether or not you
11 - - - you can defeat a motion to dismiss at that
12 stage. And then we get to the prophylactic
13 provision. We don't even get there until that point.

14 MR. KASOWITZ: Yes, Your Honor. And - - -
15 and - - - and although we've had - - - we've had the
16 argument here and - - - and the majority's decision
17 is - - - is - - - is based squarely on this issue of
18 a prophylactic provision, which was completely
19 misplaced, we submit, respectfully, in that
20 circumstance.

21 JUDGE ABDUS-SALAAM: That was - - - that
22 was an alternative position by the Appellate Division
23 majority. They said first you had to do due
24 diligence and then the second - - - or - - - or you
25 could have insisted on a prophylactic provision in a

1 contract. Which - - - which I agree with you, there
2 was no contract between you and - - - and Paulson.

3 MR. KASOWITZ: Correct.

4 JUDGE ABDUS-SALAAM: Or - - - or - - - or
5 Goldman. So there was no contract in which you could
6 have inserted a prophylactic provision. But as to
7 the first portion of the Appellate Division's
8 majority decision said, you didn't do any due
9 diligence by anything. You didn't ask Paulson what
10 their position was. You didn't do anything.

11 MR. KASOWITZ: And - - - and, in fact, Your
12 Honor, I - - - I believe it's at page 7 of the - - -
13 of the - - - of the decision, the majority said that
14 had either Goldman, which it referred - - - had
15 either Goldman or Paulson been asked, then they
16 likely would have said that there was - - - they
17 likely would have said that - - - that - - - that
18 Paulson was short.

19 Two things, Goldman was asked repeatedly.
20 There are numerous allegations - - -

21 JUDGE ABDUS-SALAAM: They never answered
22 you about that.

23 MR. KASOWITZ: That's not true, Your Honor.
24 There were ans - - - there were answers. There's a -
25 - - there are - - - there are references to - - - to

1 e-mails that reflect answers. There's a telephone-
2 recorded conversation that reflected an answer.
3 There were answers here given by Goldman. That's - -
4 - that's the first thing. So Goldman was clearly
5 asked. And - - - and - - - and Goldman answered, and
6 they were clear that - - - that - - - that Paulson
7 was the - - - that - - - that Paulson was long.

8 And - - - and, in fact, we have - - - we -
9 - - we even have in the second amended complaint,
10 which we've - - - which we were given permission to
11 file and which we sent to the court, there are
12 allegations to the effect that Goldman and Paulson
13 were conspiring, and Paulson was agreeing that it
14 would "keep to the script" and continue to identify
15 itself as an equity sponsor.

16 JUDGE RIVERA: Let's - - - let's - - -
17 let's say - - - let's say that's true. He says
18 you've got the circular and other things that,
19 nevertheless, should have been red flags. Why are
20 those things not red flags?

21 MR. KASOWITZ: Your - - - Your Honor, as I
22 explained at - - - at the beginning it's not a red
23 flag. This circular - - -

24 JUDGE RIVERA: Um-hum.

25 MR. KASOWITZ: - - - which is page 325 of

1 the record, is entitled "Notes", notes. It has to do
2 with notes. All of the characteristics on the side,
3 class, series, state of maturity, they all relate to
4 notes.

5 JUDGE RIVERA: What about the cash equity -
6 - -

7 MR. KASOWITZ: They don't - - -

8 JUDGE RIVERA: The cash equity purchase
9 that he was talking about?

10 MR. KASOWITZ: The - - - the - - - the
11 equity piece, the going long piece, related to the
12 credit default swaps. And if - - - if - - - if the
13 court is directed to paragraph 60 of our - - - of our
14 complaint, we allege clearly that our understanding
15 was that there was a credit default swap that Paulson
16 had engaged in for its - - - for its going long on
17 this transaction.

18 JUDGE PIGOTT: During this reading - - -

19 MR. KASOWITZ: There was no doubt about
20 that.

21 JUDGE PIGOTT: During this, you know,
22 reading - - - reading all this, I almost thought
23 that, you know, if you're dealing with Goldman Sachs,
24 that's due diligence. I mean they're a pretty good
25 bank. I -- I - - I would feel very comfortable

1 dealing with them.

2 MR. KASOWITZ: Well, it's a point I made
3 before, Judge Pigott. It - - - it's a point I made
4 before which is very clearly, we relied on Goldman.
5 Their counsel are now telling us that that was
6 unreasonable. Issues of fact at a minimum, Your
7 Honor.

8 CHIEF JUDGE LIPPMAN: Okay.

9 MR. KASOWITZ: We agree. Thank you.

10 CHIEF JUDGE LIPPMAN: Thank - - - thank you
11 both. Appreciate it.

12 (Court is adjourned)

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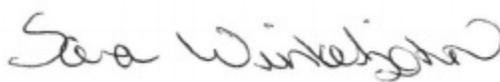
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C E R T I F I C A T I O N

I, Sara Winkeljohn, certify that the foregoing transcript of proceedings in the Court of Appeals of ACA Financial Guaranty Corp. v. Goldman, Sachs & Co., No. 49 was prepared using the required transcription equipment and is a true and accurate record of the proceedings.



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