EFiled: Mar 15 2011 7:23PM EDT
Transaction ID 36495502
Case No. 5215-CC

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE THE GOLDMAN SACHS GROUP, INC. SHAREHOLDER LITIGATION	C.A. No. 5215-CC

DEFENDANTS' REPLY BRIEF IN FURTHER SUPPORT OF THEIR MOTION TO DISMISS THE SECOND AMENDED COMPLAINT

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PRELIMINARY STATEMENT

Plaintiffs' Opposition, like their complaint, seeks to second-guess the judgment of Goldman Sachs' directors' regarding fundamental compensation and business decisions, an exercise that Delaware law precludes.[1] Despite Goldman Sachs' consistent profitability and its position in a highly competitive industry, the Opposition attacks the firm's overall compensation levels based on distorted financial metrics and inapposite comparisons with competitors. Yet Plaintiffs do not identify a single precedent in which any court has permitted such a broadbrush assault. There is neither a need nor a basis for the Court to address the merits of Plaintiffs' claims, because the Opposition fails to carry its heavy burden of establishing that a majority of Goldman Sachs' directors were incompetent to consider a pre-suit demand as to these core matters of business judgment.

Plaintiffs' only basis for challenging the independence of half of the Board members—their affiliations with charitable or educational institutions to which the Goldman Sachs Foundation has made donations—has been rejected repeatedly by other courts, including as to the same directors and charitable donations. (*See* Mem. at 20-24.) Indeed, this Court recently rejected a challenge to a board's independence where there was similarly no showing that the directors received salaries from, or personally solicited donations on behalf of, their respective charities. *See S. Muoio & Co.* v. *Hallmark Entm't Invs. Co.*, C.A. No. 4729-CC (Del. Ch. Mar. 9, 2011) (Koch Supp. Decl. Ex. A). The Opposition presents no basis for distinguishing these precedents, let alone for concluding that the independence of the majority of Goldman Sachs' directors was compromised in any respect. (*See* Opp. at 24.)

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[1] Abbreviations in this memorandum have the same meanings as those in Defendants' Brief in Support of Their Motion to Dismiss the Second Amended Complaint ("Mem.").

Plaintiffs' Opposition also fails to establish that the conduct at issue here was "so egregious" as to remove defendants' deliberations from the province of the business judgment rule and to create "a substantial likelihood of director liability." *Aronson* v. *Lewis*, 473 A.2d 805, 815 (Del. 1984). Having acknowledged that Goldman Sachs considers its success "fuel[ed]" by its employees and that Goldman Sachs chose to link its "pay to performance" (Compl. ¶¶ 87, 108), Plaintiffs' Opposition takes the contradictory (and illogical) position that, by purportedly setting aggregate compensation for its personnel based on Goldman Sachs' net revenues, defendants paid compensation that was "unrelated to employee performance" and that wasted corporate assets. (*See, e.g.*, Opp. at 30.) That proposition is plainly flawed: Nothing could be more fundamental in aligning employee and shareholder interests than linking profitability and compensation (particularly when the compensation includes significant deferred equity which aligns those interests even further).

At most, Plaintiffs' claims are based on a fundamental disagreement with the business judgment of Goldman Sachs' Board as to the percentage of net revenues that is appropriate to pay and retain personnel in light of firm performance and in a highly competitive market. (*See* Opp. at 30-34.) Significantly, Plaintiffs admit they do not challenge the compensation awarded to any individual Goldman Sachs employee or business unit, and their contested financial metrics fall far short of a showing of the *bad faith* by Goldman Sachs' Board that would expose their determinations to judicial scrutiny. Plaintiffs do not remotely satisfy the "extreme test" of showing that Goldman Sachs' compensation was "so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration." (Opp. at 36 (quoting *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 74 (Del. 2006)).)

Nor do Plaintiffs' arguments concerning alleged failures of oversight establish a substantial likelihood of director liability sufficient to excuse demand. Plaintiffs' argument that the Board permitted Goldman Sachs to take on excessive financial and reputational risk is simply a disagreement with the Board's business judgment regarding the optimal weighting of risk versus reward, and fails to excuse demand absent a showing of bad faith, because "[b]usinesses—and particularly financial institutions—make returns by taking on risk." *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 126 (Del. Ch. 2009). Plaintiffs' admission that Goldman Sachs publicly disclosed and "manage[d]" conflicts of interest inherent in its business (Opp. at 11-12) forecloses any argument that the Board "utterly failed to implement any reporting or information system or controls," or "consciously failed to monitor or oversee its operations." *Stone* v. *Ritter*, 911 A.2d 362, 370 (Del. 2006). And Plaintiffs have failed to show that even a single Goldman Sachs director was aware of any of the allegedly flawed disclosures in connection with the isolated transaction that led Goldman Sachs to enter into a civil settlement with the SEC.

In sum, Plaintiffs seek to usurp board control over core areas of business judgment and to substitute their own views on matters including compensation, dividend policy, and financial leverage. On their face, Plaintiffs' claims conflict with, and are barred by, the "fundamental precept that directors manage the business and affairs of corporations." *Aronson*, 473 A.2d at 812. For the same reasons, the Opposition fails to show how these invasive theories state a claim under Delaware law.

ARGUMENT

I. PLAINTIFFS' OPPOSITION CONFIRMS THAT DEMAND IS NOT EXCUSED.

The Opposition fails to demonstrate, consistent with "stringent requirements of factual particularity," why a demand was not made. *Brehm* v. *Eisner*, 746 A.2d 244, 254 (Del. 2000); *see*, *e.g.*, Ct. Ch. R. 23.1; Mem. at 18-19. As Plaintiffs acknowledge, this standard is more stringent than that required to survive a motion to dismiss for failure to state a claim. (*See* Opp. at 49-50.)

The Opposition fails to point to particularized facts in the Complaint creating a reasonable doubt that "the directors are disinterested or independent," or that the challenged Board action was "the product of a valid exercise of business judgment." *Brehm*, 746 A.2d at 256 (quoting *Aronson*, 473 A.2d at 814). And Plaintiffs fare no better under the test in *Rales* v. *Blasband*, 634 A.2d 927 (Del. 1993), for challenges to alleged Board inaction, which asks whether "the particularized factual allegations of [the complaint] create a reasonable doubt that . . . the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand." *Id.* at 934.[2]

A. Plaintiffs Have Failed to Plead That Any Director Lacks Independence Because of Any Financial or Other Relationship.

When the Complaint was filed and initially amended, the same twelve directors sat on the Goldman Board. (*See* Mem. at 21 n.10.) Two were employees. Plaintiffs have raised no challenge to the ability of two others, Messrs. George and Schiro, to consider a demand. Accordingly, Plaintiffs are required to plead with particularity that at least four of the remaining

2 Plaintiffs incorrectly contend that the standard for pleading director knowledge of misconduct set forth in *Wood* v. *Baum*, 953 A.2d 136 (Del. 2008), "is applicable only in that case." (Opp. at 28 n.17.) Courts have applied this standard to corporations, not just limited liability companies. *See Citigroup*, 964 A.2d at 125 (applying *Wood* standard); *La. Mun. Police Employees Ret. Sys.* v. *Blankfein*, No. 08 Civ. 7605 (LBS), 2009 WL 1422868, at *8 (S.D.N.Y. May 19, 2009) (same).

eight Director Defendants are "disabled from exercising independent judgment." *See J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 808, 821 (Del. Ch. 2005). The Opposition does not come close to meeting that burden.

Service on Philanthropic Boards. Plaintiffs' sole basis for challenging the independence of five Director Defendants—Bryan, Gupta, Juliber, Simmons, and Johnson—is that they sit on advisory boards or serve as trustees or directors of charitable organizations that have received donations from the Foundation. (*See* Opp. at 24; Compl. ¶¶ 157-59, 161-62.) Just days ago, this Court underscored that such bare allegations fail to establish director dependence.

In *Muoio*, the plaintiff challenged the independence of a special committee member affiliated with charities supported by the company's controlling shareholder, Hallmark Cards. *See Muoio*, slip op. at 27. The Court rejected the argument that this relationship established the director's dependence on Hallmark, noting that the plaintiff had not established that the special committee member received compensation for his charitable services or that the special committee member personally had solicited donations from Hallmark. *Id.* at 27-28. As the Court explained, in cases that have found that such directors lacked independence, the directors "were paid a salary by the [charity] that received the donations, and they personally solicited donations from (or had other substantial dealings with) the donors." *Id.* at 28.

Here, as in *Muoio*, the Complaint does not allege as to any of these directors that the donations at issue were material to the charity; or that the directors used their respective directorships or relationships with a controlling director to obtain a disproportionately large donation from Goldman Sachs. *See J.P. Morgan* , 906 A.2d at 822-23 & n.48. As a New York federal court recently held when rejecting a nearly identical challenge to the same Goldman Board, "[w]ithout any allegations regarding the scope or magnitude of the charities, donations, or director affiliations . . . Plaintiff[s'] donation allegations do not establish lack of independence for the purpose of demand futility." *LMPERS*, 2009 WL 1422868, at *6. Although Plaintiffs claim that *J.P. Morgan* and *LMPERS* do not "necessitate[]" dismissal (Opp. at 26), Plaintiffs do not and cannot distinguish these decisions.

Indeed, the decision on which Plaintiffs principally rely highlights the pleading deficiencies of their Complaint. (*See* Opp. at 24 (citing *In re The Limited, Inc. S'holders Litig.*, C.A. No. 17148-NC, 2002 WL 537692 (Del. Ch. Mar. 27, 2002)).) In *The Limited*, the director at issue owed his livelihood to the university to which charitable donations had been made, and personally requested a $25 million gift that was "significant" for a "school of that size" and "was a positive reflection" on the director and his "fundraising efforts as university president." *Id.* at *6-7. Taken together, these facts could reasonably be viewed "as instilling in [the director] a sense of 'owingness' to [the controlling officer]." *Id.* at *6-7 & n.41.[3] By contrast, the Complaint here establishes only that the Foundation and certain directors support some of the same charities.

In addition, contrary to the unsupported assertions in Plaintiffs' Opposition that Goldman Sachs management somehow controls the Foundation (Opp. at 24; Compl. ¶ 153), Plaintiffs fail to plead adequately that Goldman Sachs had the power to cause the Foundation's separate board to make such charitable donations. (Mem. at 22, n.11.) Indeed, in *Bader* v. *Blankfein*, the Court rejected allegations regarding charitable ties nearly identical to those in this

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[3] The two remaining decisions cited by Plaintiffs are wholly inapposite. *See* Opp. at 24. In *In re Freeport-McMoRan Sulphur, Inc. S'holder Litig.*, the Court did not reach plaintiffs' arguments regarding charitable ties, because other allegations established that a majority of the directors were interested. C.A. No. 16729, 2005 WL 1653923, at *13 (Del. Ch. June 30, 2005). *In re Ply Gem Industries, Inc. Shareholders Litigation* does not involve beholdenness based on charitable contributions at all. Rather, the Court denied reconsideration of its holding that certain unspecified pre-merger "benefits" provided by a dominating director may continue to disqualify directors after the challenged merger. C.A. No. 15799-NC, 2001 Del. Ch. LEXIS 123, at *4 (Del. Ch. Sept. 28, 2001).

action,[4] that failed to allege with particularity "that Goldman had 'the unilateral power' to decide whether the challenged director continues to receive a benefit" in the form of additional charitable contributions. *Id*. (internal alterations omitted). Plaintiffs' allegations here suffer from the same deficiency.

In short, the Opposition identifies no particularized facts to suggest that the Foundation's charitable donations raise a doubt as to any director's ability to consider a demand independently. Accordingly, even if Plaintiffs could establish (which they cannot) that the three remaining directors lack independence, Plaintiffs have failed to meet their burden to plead with particularity that a majority of directors are interested or dependent.

Alleged Business Relationships. The Opposition also assails the independence of three other outside directors based on their businesses' routine commercial relations with Goldman Sachs. None of those relationships renders these directors incompetent to consider a demand. *See J.P. Morgan*, 906 A.2d at 821-24.

- *Mittal:* Plaintiffs argue that Defendant Mittal is beholden to "Goldman management" because ArcelorMittal (the world's largest steel company, with which Mr. Mittal is affiliated) hired Goldman Sachs to arrange financing or credit. (*See* Opp. at 23 & n.13.) But the Opposition, like the Complaint, identifies no particularized allegations suggesting anything remarkable about this business connection that would render Mr. Mittal incapable of evaluating a demand. Absent such particularized allegations, it is settled Delaware law that "the existence of contractual relationships with companies that directors are affiliated with . . . does not sterilize the board's ability to decide." *Jacobs* v. *Yang*, C.A. No. 206-N, 2004 WL 1728521, at *6 (Del. Ch. Aug. 2, 2004) (internal quotations omitted); *see also Sec. Police & Fire Prof'ls of Am. Ret. Fund* v. *Mack*, ___ N.Y.S.2d ____, 2010 WL 5094348, at *13 (N.Y. Sup. Ct. Dec. 9, 2010) (finding insufficient to excuse demand allegations that Morgan Stanley and corporation for which director served as executive co-owned a real estate investment company, where plaintiff "fail[ed] to assert 'particularized facts establishing that the

[4] *Compare*, *e.g.*, No. 07 Civ. 1130 (SLT), 2008 WL 5274442, at *8 n.5 (E.D.N.Y. Dec. 19, 2008) (challenge to director Gupta because of Foundation donations to the Indian School of Business and Tsinghua University School of Economics and Management) *with* Opp. at 25 (same).

business relationship[is] *material*'") (quoting *Jacobs*, 2004 WL 1728521, at *6) (emphasis in original).

- *Dahlbäck and Friedman:* The Opposition also contends that defendants Dahlbäck, and Friedman are not independent because they have "financial business ties" with "the Company and the Foundation," which Plaintiffs conclusorily allege are "controlled by" certain unnamed members of "Goldman management." (Opp. at 21.) With respect to *these* defendants, the Opposition uses the word "livelihood" (*see id.* at 21, 22), but fails to identify any particularized allegations in the Complaint showing that these directors are beholden to any other director or Goldman Sachs. Plaintiffs do not allege or even argue that any fees paid by Goldman Sachs to investment funds advised by Mr. Dahlbäck affected his personal compensation (or, if so, to what extent); nor have Plaintiffs alleged that Mr. Dahlbäck was personally involved in the fund's business or investment with Goldman Sachs. (*See* Compl. ¶ 160; Opp. at 22-23.) The same principles apply with even greater force to Plaintiffs' allegations and argument regarding Mr. Friedman, who Plaintiffs allege manages funds that include investments by Goldman Sachs.[5] (*See* Compl. ¶ 165; Opp. at 22 & n.12.)[6] *See Jacobs*, 2004 WL 1728521, at *6; *Mack*, 2010 WL 5094348, at *13.

Such generalized allegations of business and professional relationships cannot, without more, establish the "beholdenness" of any Goldman Sachs director. Contrary to Plaintiff's self-serving characterization (Opp. at 23 n.14), *J.P. Morgan* rejected allegations of business ties that were more significant than those alleged here. In *J.P. Morgan*, the allegedly dependent director was Chairman, CEO and director of a company that received $2 billion in financing from an entity managed by the defendant corporation. 906 A.2d at 814. There, as here, the plaintiffs did not allege with particularity that the business relationship between J.P. Morgan and the entity with which certain directors were affiliated "somehow connected to [the director's] relationship" with J.P. Morgan or that "future . . . work would be jeopardized if [the

[5] Plaintiffs' similar bare-boned allegations regarding charitable donations to Columbia University, where Mr. Friedman is a trustee emeritus (Compl. ¶ 160), fail for the same reasons as those applicable to Plaintiffs' allegations regarding donations to organizations with which other defendants are affiliated.

[6] Plaintiffs' attempt to excuse their failure even to identify the funds that Mr. Friedman allegedly "manages" and in which Goldman Sachs allegedly invested is unavailing. *Compare Katz v. Halperin*, C.A. No. 13811, 1996 WL 66006, at *6 (Del. Ch. Feb. 5, 1996) (conclusory allegations that director "provided accounting services" to dominating directors and entities under their control did not excuse demand) *with* Opp. at 22 n.12.

director] voted against" any other allegedly interested officer or director. *Id*. at 821-22. Similarly, the allegations of business ties rejected in *Khanna* v. *McMinn*, C.A. No. 20545-NC, 2006 WL 1388744, at *16 (Del. Ch. May 9, 2006), were more particularized than Plaintiffs' conclusory allegations here. In *Khanna*, the plaintiff alleged that a company of which a director was CEO purchased more than $3.1 million in services from the defendant corporation and made "many millions more" by selling services to customers "at a mark-up." *Id.* at *21-22. The Court held that the demand futility allegations were insufficient because the plaintiff had failed to allege the extent to which the defendant corporation "profit[ed]" from the business relationship, "the terms of [the] business dealings" between the corporations, or "facts permitting the Court to infer . . . that [the business] relationship . . . is material." *Id.* So, too, here.

Similarly, the decisions on which Plaintiffs rely (Opp. at 21-22) all involved very different allegations, which gave rise to strong inferences of domination and control:

- In *Steiner* v. *Meyerson*, the plaintiff alleged that the CEO "possesse[d] the authority to hire and fire" the "small law firm" at which the dependent director was a partner, and for which the corporation's $1 million in legal fees per year were material. C.A. No. 13139, 1995 Del. Ch. LEXIS 95, at *30-31 (Del. Ch. July 19, 1995).

- In *Friedman* v. *Beningson*, a director was beholden to the chairman and CEO, because the dependent director acted as a consultant to the corporation, and the CEO could terminate his consultancy. C.A. No. 12232, 1995 Del. Ch. LEXIS 154, at *14-15 (Del. Ch. Dec. 4, 1995).

- In *Rales* v. *Blasband*, the dominating directors had the power unilaterally to fire the dependent directors in connection with their main employment. 634 A.2d at 937.

- In *In re Walt Disney Co. Derivative Litigation*, a director was beholden to the CEO because the director, an architect, had been personally commissioned to design several buildings for the company and CEO. 731 A.2d 342, 357-58 (Del. Ch. 1998).[7]

[7] Defendants assume that Plaintiffs meant to cite Walt Disney, but mistakenly cited Brehm (Opp. at 22), as Brehm never reached the issue of dependence.

The absence of any similar, particularized allegations of control here further requires rejection of Plaintiffs' independence arguments.

B. Plaintiffs Have Not Shown That the Directors' Compensation Decisions Were Anything But Good-Faith Business Judgments.

As Plaintiffs concede (Opp. at 27-28 & n.16), Goldman Sachs' certificate of incorporation exculpates directors from liability for breaches of fiduciary duty absent bad faith, willful misconduct or a breach of the duty of loyalty. (*See also* Mem. at 26 n.16.) Neither the Complaint nor the Opposition makes that showing.

Plaintiffs admit that Goldman Sachs received valuable services from its personnel, who "fuel[ed]" its success (Complaint ¶ 108), and that Goldman Sachs set compensation, with the assistance of its Compensation Committee (which included no "inside" directors), in the ordinary course of business. Plaintiffs also do not challenge any payment to any specific employee. These deficiencies distinguish Plaintiffs' claims from derivative cases in which courts considered the merits of a challenge to compensation paid to particular employees. *See generally Mack*, 2010 WL 5094348 (demand not excused in suit challenging financial institution's overall compensation); *cf.*, *e.g.*, *Citigroup*, 964 A.2d at 138 (demand excused in suit challenging CEO's severance package).

In essence, Plaintiffs simply disagree with the value that Goldman Sachs' Board places on the services provided by Goldman Sachs personnel as a whole. Plaintiffs accordingly challenge one of the most sacrosanct determinations within the core of the business judgment rule; it is black-letter law that Goldman Sachs' Board possesses "*wide discretion* to make decisions on executive compensation." *Brehm*, 746 A.2d at 262 n.56 (emphasis added). "[T]he setting of compensation is presumed to have been in good faith and in the best interests of the corporation. Thus, courts are generally reluctant to inquire into the reasonableness of the executive compensation where such is fixed by a disinterested board." *Pogostin* v. *Rice*, C.A. No. 6235, 1983 Del. Ch. LEXIS 437, at *12 (Del. Ch. Aug. 12, 1983), *aff'd*, 480 A.2d 619 (Del. 1984) (internal citations omitted). There are "outer limits" on compensation, but only in "unconscionable cases where directors irrationally squander or give away corporate assets." *Brehm*, 746 A.2d at 263; *see Grimes* v. *Donald*, 673 A.2d 1207, 1215 (Del. 1996) (compensation decisions protected by business judgment rule absent waste), *overruled on other grounds by Brehm*, 746 A.2d 244. Plaintiffs' Opposition confirms that the Complaint does not come close to meeting these standards.

1. Plaintiffs Identify No Goldman Sachs Employee Who Allegedly Received Wasteful Compensation.

As a threshold matter, Plaintiffs identify no legal precedent for challenging the aggregate compensation paid to tens of thousands of Goldman Sachs employees, without any reference to who these employees are or what services they performed for the corporation. Although Plaintiffs admittedly are not challenging "a specific employee's overcompensation," (Opp. at 32), they nonetheless rely on decisions finding demand excused where excessive compensation was paid to a *particular executive* who provided essentially nothing in return.[8] (*See* Opp. at 36-39.) The determinations involved in setting the particular compensation of any one of these employees are shielded by the business judgment rule; that protection is even

[8] *See Citigroup*, 964 A.2d at 138 (demand excused where departing CEO received $68 million and other benefits on his departure, notwithstanding "billions of dollars of losses"); *Sample* v. *Morgan*, 914 A.2d 647, 669-70 (Del. Ch. 2007) (stock-option award giving three executives one-third of voting and dividend rights of corporation for nominal price was wasteful); *Kovacs* v. *NVF Co.*, C.A. No. 8466, 1987 Del. Ch. LEXIS 486, at *9 (Del. Ch. Sept. 16, 1987) (noting in *dicta* that individual executive's compensation appeared to be excessive where corporations paying the compensation "are suffering great losses and some are in, or have been, or may soon be, bankrupt"); *cf. Brehm*, 746 A.2d at 263 (compensation award to executive was not wasteful because board determined "he would be valuable").

greater where shareholders challenge the *aggregate* levels of compensation for the firm's entire employee population. *See generally Mack*, 2010 WL 5094348.

"[A] corporate waste claim must fail if there is *any substantial* consideration received by the corporation, and . . . there is a *good faith judgment* that in the circumstances the transaction is worthwhile." *White* v. *Panic*, 783 A.2d 543, 554 (Del. 2001) (internal quotation marks omitted; emphases and ellipsis in original). (Mem. at 30.) Here, it cannot seriously be disputed that Goldman Sachs' employees have provided and continue to provide valuable services that have contributed to the firm's continuing profitability through extraordinarily challenging economic circumstances.[9] Regardless of whether any *particular* employee's compensation exceeds his or her contribution, as a matter of law it cannot be wasteful—and it is fully within the limits of the business judgment rule—for a profitable corporation to set compensation levels for its employees. *See Brehm*, 746 A.2d at 263 (compensation is not wasteful unless it is "so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration") (internal quotation omitted).

2. No Authority Supports Plaintiffs' Challenge to Goldman Sachs' Company-Wide Compensation Levels.

Plaintiffs cite no decision—and defendants are aware of none—holding that a board breached its fiduciary duties by setting *company-wide* compensation at a level that a shareholder considers excessive. In fact, the Opposition does not identify any decision excusing demand on the ground that aggregate compensation as a percentage of net revenues was allegedly excessive. In support of their unprecedented claims, Plaintiffs invite this Court to

[9] Plaintiffs' conclusory assertion that Goldman Sachs' survival and profits in the financial crisis resulted from "intervention of the Federal Government" and exploitation of Goldman Sachs' clients (Opp. at 8 n.5) is inconsistent with the Complaint's acknowledgment that Goldman Sachs personnel "fuel" the firm's profitability. (*See* Compl. ¶ 108 (employees are "fueling" a "revenue and profit surge").)

break new ground because the Supreme Court purportedly has "left open the possibility of a broader set of circumstances on which a disloyalty claim could be based." (Opp. at 29.) But Plaintiffs ignore that Delaware courts have made clear that "a very extreme set of facts would seem to be required to sustain a disloyalty claim," *In re Lear Corp. S'holder Litig.*, 967 A.2d 640, 654 (Del. Ch. 2008), and that, to sustain a claim based on excessive compensation, Plaintiffs would have to show that the Board "lacked independence (*e.g.*, was dominated or controlled by the individual receiving the compensation)" or otherwise "lacked an actual intention to advance corporate welfare . . . in making the award." *Gagliardi* v. *TriFoods Int'l, Inc.*, 683 A.2d 1049, 1051 (Del. Ch. 1996).

In fact, a New York court construing Delaware law has squarely rejected Plaintiffs' argument, and Plaintiffs' attempts to distinguish that case are unpersuasive. *Mack* held that challenges to firm-wide compensation are protected by the business judgment rule and that the plaintiffs could not raise a reasonable doubt that the defendants had exceeded their substantial discretion absent allegations that specific personnel had failed to provide services to the corporation and that the directors were aware of that deficiency when they made their compensation decisions. *See* 2010 WL 5094348, at *11. Even putting aside the "computational error" that Plaintiffs now concede incorrectly inflated the Goldman Sachs per-employee compensation amounts alleged in the Complaint (Opp. at 7 n.4), the compensation levels in *Mack* were substantially higher than those alleged here.[10]

Second, Plaintiffs' contention that Goldman Sachs' "allocation decision was arbitrary" and "not structured to incentivize, reward or retain employees" (Opp. at 36) lacks any foundation, and the Complaint does not allege with specificity that defendants robotically allocated to compensation the same percentage of net revenues annually rather than managing compensation fluidly and in light of the firm's performance and competitive environment. Moreover, if the Board had set compensation at a fixed percentage of net revenue, such an approach would still link compensation to performance because, if Goldman Sachs' net revenues increased, *both* corporate profits *and* the funds available to compensate employees would increase. Plaintiffs' contention also says nothing about how Goldman Sachs made individualized compensation decisions for its more than 30,000 employees, which together comprise the aggregate compensation Plaintiffs challenge.

Third, Plaintiffs' contention that Morgan Stanley's Board approved only a "bonus pool" rather than "*total* compensation" (Opp. at 36), raises a distinction without a difference. The *Mack* court observed merely that several factors could have led to an increase in total compensation, such as an increase in the number of employees, an increase in base pay, or an increase in the cost of labor. *Mack*, 2010 WL 5094348, at *8.

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10 In *Mack*, plaintiffs argued that the ratio of compensation to net revenues was excessive, including because Morgan Stanley allegedly would have "collapse[d] but for a $10 billion TARP loan by the federal government." 2010 WL 5094348, at *3. The *Mack* court rejected plaintiffs' challenge to Morgan Stanley's 2009 compensation at a ratio of 62% of net revenues, *see id*. at *9, whereas Plaintiffs speculate here that Goldman Sachs would have paid compensation in 2009 at a 50% ratio of net revenues and in fact ended up paying compensation corresponding to 35.8% of net revenues (Opp. at 5-6). Moreover, the *Mack* court did not find the compensation ratio there excessive where Morgan Stanley's revenues decreased from $28 billion in 2008 to $23 billion in 2009, *see* 2010 WL 5094348, at *9, whereas during the same period Goldman Sachs's net revenues doubled (Compl. ¶ 116).

Fourth, Plaintiffs' argument that Goldman Sachs failed appropriately to consider the company's financial position in both 2007 and 2008 during the financial crisis when setting compensation (even if cognizable) is contradicted by Plaintiffs' own allegations. Goldman Sachs' aggregate compensation and benefits in 2008—the year in which financial institutions such as AIG and Lehman Brothers failed outright—was 46% lower than 2007 levels. (*See* Koch Decl. ¶¶ 18-19.) Plaintiffs' myopic focus on the aggregate ratio of compensation and benefits to net revenues ignores actual dollar compensation amounts, which historically rise or fall based on business conditions, competitive considerations, and the business judgment of Goldman Sachs' senior executives and Board.

3. Plaintiffs Do Not Show That Any Director Acted in Bad Faith.

Instead of alleging particularized facts that establish with specificity that Goldman Sachs' Board acted in bad faith, Plaintiffs baldly contend that every director acted disloyally and in bad faith by allocating a supposedly "staggering proportion of Defendants' net revenues to . . . employees, before any compensation determination was made with respect to them." (Opp. at 30.) Plaintiffs' arguments suffer from factual, legal and logical flaws that, in fact, show that Goldman Sachs' Board properly exercised its business judgment:

- Plaintiffs' complaint that the percentage of net revenues is "unrelated to employee performance" is nonsensical. (Opp. at 30.) Plaintiffs' focus on their chosen metric of "percentage of net revenues" ignores that total compensation at Goldman Sachs follows no such reflexive command and fluctuates significantly from year to year, and that the percentage is a product of a robust compensation process rather than the starting place.[11]

- Plaintiffs' complaint that Goldman Sachs' Board should be paying dividends at a level higher than 2% of net revenues instead of retaining

[11] Total compensation and benefits declined by 46% from 2007 to 2008 during the financial crisis. (*See* Compl. ¶ 116.) Likewise, per-employee compensation has varied widely from year to year. (*See* Koch Decl. ¶¶ 17-20.)

earnings is both unfounded and not cognizable here. (Opp. at 30.) There has been no showing that Goldman Sachs' dividend policy is the product of "fraud or gross abuse of discretion."[12] *Gabelli & Co.* v. *Liggett Group, Inc.*, 479 A.2d 276, 280 (Del. 1984).

- Plaintiffs' contention that Goldman Sachs' average per-employee compensation has been "consistently and enormously excessive" compared to that of Goldman's supposed "peers in its industry" (Opp. at 30; *cf.* Section I.B.2, *supra*) is based on an admitted "computational error" by Plaintiffs: namely, that the Complaint grossly overstates Goldman Sachs' average per-employee compensation and benefits expense (Opp. at 7 n.4). Plaintiffs' comparison makes no effort to account for the different business models and structures of different institutions, but, in any event, Goldman Sachs' average per-employee compensation and benefits expense has been broadly consistent with, and at times lower than, the average per-employee compensation and benefits expense at other large banks.[13]

- Putting aside the irrelevance of the comparison, Plaintiffs' argument that Goldman Sachs' total compensation is more generous than that of a hedge fund's "2% of net assets plus 20% of net income" is also conceptually and mathematically flawed. (Opp. at 31.) If Goldman Sachs used the actual hedge fund method—2% of total assets under management and 20% of net income—total 2009 compensation would have been $19.7 billion (*i.e.*, 2% of Goldman Sachs' total assets of $848.9 billion, plus 20% of Goldman Sachs' net earnings of $13.385 billion). (*See* Compl. ¶115; Goldman Sachs 2009 Form 10-K at 98, 125 (Koch Supp. Decl. Ex. E).) That is far higher than Goldman Sachs' actual 2009 compensation of $16.2 billion. (Compl. ¶ 116.)

- There is nothing improper about a board's "consult[ing] with management" about compensation. (Opp. at 30.) Boards have "wide discretion" in setting compensation, *Brehm*, 746 A.2d at 262 n.56, and

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12 Even using Plaintiffs' odd metric of "dividends as percentage of net revenues," Goldman Sachs' dividend of 1.2% of net revenues exceeds the dividends paid by other financial institutions. (*Compare* Complaint ¶ 123 *with*, *e.g.*, Morgan Stanley 2009 Form 10-K at 30, 33, 34 (reflecting dividends of 1.0% of net revenues, calculated by multiplying total 2009 dividends per share by the number of outstanding shares, then dividing by net revenues) (Koch Supp. Decl. Ex. B); Bank of America Corp. 2009 Form 10-K, at 24, 26 (.3%) (Koch Supp. Decl. Ex. C); Citigroup, Inc. 2009 Form 10-K, at 9, 13 (.4%) (Koch Supp. Decl. Ex. D)). This court may properly take judicial notice of these facts on a motion to dismiss. *See In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 170 (Del. 2006) (court may take judicial notice of facts disclosed in company's SEC filings that are not subject to reasonable dispute).

13 *Compare* Koch Decl. ¶¶ 17-20 (correctly calculating Goldman Sachs' per-employee compensation and benefits expense in 2006 through 2009), *with* Compl. ¶ 119 (alleging per-employee compensation and benefits expense of Goldman Sachs' supposed "peers" in 2006 through 2009).

consultations with management (who are in the best position to assess the competitive environment) not only are permitted by Delaware law, but evidence the Board's deliberative exercise of its business judgment.

- Plaintiffs' speculative argument that excessive compensation was paid in the past based on trades that potentially are subject to future "put-backs" of supposedly fraudulent loans, excessive risk-taking, or other "employee excesses" makes no sense. (Opp. at 31.) Mortgage put-backs that have yet to occur, and that may never occur, could not have formed the basis of compensation decisions years ago, and any argument that the company took on excessive business risk is simply a variant of Plaintiffs' deficient *Caremark* claim, discussed below.

It is evident even from the face of the Complaint that the Goldman Sachs Board exercises business judgment in setting compensation, as Plaintiffs' preferred metric—the percentage of net revenues associated with compensation—has varied over the past decade and declined from the previous year in 2009. (*See* Compl. ¶ 115.) Although Plaintiffs suggest that this reduction supposedly was only a reaction to "public outcry," (*id.* at ¶ 108), they do not contest—and, in fact, expressly plead—that defendants set the level of total compensation based on business considerations that defendants considered relevant in the exercise of their managerial discretion with the benefit of the record revenues that year. (*See id.* at ¶¶ 125-130 (noting "widespread criticism" facing Goldman Sachs and prospects for new taxes and fees).)

Plaintiffs' laundry list of complaints distills to a simple and non-justiciable argument that, in Plaintiffs' view, the overall level of compensation at Goldman Sachs is excessive to some unspecified degree, and that Plaintiffs would have paid Goldman Sachs employees less. That is nothing more than a disagreement with the business judgment of Goldman Sachs' Board, which cannot excuse demand.

C. Plaintiffs Fail Adequately to Plead That Any Defendant Faces a "Substantial Likelihood" of Liability for Any Oversight Claim.

Plaintiffs concede that a showing of bad faith is required to demonstrate director liability based on a lack of oversight (Opp. at 39-40)—"possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment." *In re Caremark Int'l Inc. Deriv. Litig*., 698 A.2d 959, 967 (Del. Ch. 1996). Here, however, Plaintiffs have not alleged with the required particularity either "intentional dereliction of duty, a conscious disregard for one's responsibilities," or "conduct motivated by subjective bad intent" on the part of any of the Director Defendants. *Walt Disney*, 906 A.2d at 66 (emphasis omitted); *Lyondell Chem. Co.* v. *Ryan*, 970 A.2d 235, 243 (Del. 2009).[14] Nor have Plaintiffs demonstrated, as they must, that the Director Defendants "utterly failed to implement any reporting or information system or controls" or "consciously failed to monitor or oversee" operations through such systems or controls, *Stone*, 911 A.2d at 370. In short, Plaintiffs' claims are little more than impermissible second-guessing of the Goldman Sachs Board's business judgments concerning strategy, capital structure, and risk management.

Plaintiffs nonetheless contend that the Director Defendants failed to monitor adequately allegedly "unethical" or "risky" employee behavior in the firm's trading and mortgage units, namely the supposed "develop[ment of] a system of counter-party trading that pitted Goldman against its clients" (Opp. at 11, citing Compl. ¶ 51), and the entry into $10.9 billion of "mortgage securities transactions" (Opp. at 16, citing Compl. ¶¶ 11, 65-67, 69,

14 Plaintiffs' attempt to undercut this scienter-based standard, (Opp. at 28-29 & n.17), is without merit. It is well-settled that "a failure to act in good faith requires conduct that is qualitatively different from, and more culpable than, the conduct giving rise to a violation of the fiduciary duty of care (*i.e.*, gross negligence)" and that such conduct must be knowing and intentional. *Stone*, 911 A.2d at 369 (citing *Walt Disney*, 906 A.2d at 66).

70, 73, 75, 76, 83, 84). Plaintiffs' allegations fail even to state a claim—let alone to establish a substantial likelihood of director liability sufficient to excuse demand.

1. Plaintiffs Admit That Goldman Sachs Had Oversight Mechanisms.

Under the first prong of the *Caremark* standard, "only a sustained or systematic failure of the Board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to [oversight] liability." *Caremark*, 698 A.2d at 971. Establishing a *Caremark* claim requires "fact pleading," such as "contentions that the company lacked an audit committee, that the . . . audit committee . . . met only sporadically and devoted patently inadequate time to its work, or that the audit committee had clear notice of serious . . . irregularities and simply chose to ignore them or, even worse, to encourage their continuation." *Guttman* v. *Huang*, 823 A.2d 492, 507 (Del. Ch. 2003).

Plaintiffs concede that Goldman Sachs had a fully functioning Audit Committee that was charged with monitoring "market, credit, liquidity and other financial and operational risks" (Compl. ¶ 78; Opp. at 41-42), as well as a committee of executives responsible for overseeing the mortgage department (Compl. ¶¶ 59-60, 66). Plaintiffs also admit that Goldman Sachs acknowledged and disclosed the existence of potential conflicts of interest within its business operations, which the firm endeavored to address in the exercise of its business discretion. (Opp. at 11-12 (citing Compl. ¶ 52).)

Given the existence of these systems that are "reasonably designed . . . to allow management and the board . . . to reach informed judgments concerning both the corporation's compliance with law and its business performance," *Caremark*, 698 A.2d at 970, Plaintiffs are reduced to alleging that Goldman Sachs did not have "*proper* oversight mechanisms in place"

(Opp. at 44 n.24). But even if such hindsight-based criticisms were actionable (and under Delaware law they are not), Plaintiffs' claims must fail because they do not "specify *how* the board's oversight mechanisms were inadequate or how the director defendants knew of these inadequacies and consciously ignored them." *Citigroup*, 964 A.2d at 128.

2. Plaintiffs Do Not Allege a Bad-Faith Lack of Oversight.

The Complaint also is deficient because it does not allege particularized facts sufficient to show that the Director Defendants "knew that they were not discharging their fiduciary obligations." *Stone*, 911 A.2d at 370. Plaintiffs contend that defendants should have been on notice of "the risk-laden growth of [Goldman Sachs'] Trading Segment" and of that division's "unethical and risky trading practices and the ramifications that could and did follow." (Opp. at 40, 42.) But "the essence of the business judgment of managers and directors" of any company—"particularly financial institutions"—"is deciding how the company will evaluate the trade-off between risk and return." *Citigroup*, 964 A.2d at 126.

While Plaintiffs' Opposition is peppered with conclusory references to supposed "red flags" that defendants allegedly ignored or insufficiently managed, Plaintiffs "fail to plead 'particularized facts suggesting that *the Board* was presented with 'red flags' alerting it to potential *misconduct*' at the Company." *Citigroup*, 964 A.2d at 128 (quoting *David B. Shaev Profit Sharing Account* v. *Armstrong*, C.A. No. 1449-N, 2006 WL 391931, at *3 (Del. Ch. Feb. 13, 2006)) (emphasis added). Plaintiffs cite only one specific, non-speculative instance of supposed misconduct: allegedly inadequate disclosures made in connection with *one* transaction that led to *one* civil settlement with the SEC, in which there has been neither an acknowledgement nor a finding of liability.[15] (*See* Opp. at 13-15.) Plaintiffs offer no particularized allegation that any Goldman Sachs director was aware of, but consciously disregarded, any alleged misconduct associated with this or any other transaction.

Nor can Plaintiffs salvage their *Caremark* claim by arguing that executive defendants Blankfein and Cohn had a heightened duty of oversight by virtue of their membership on a committee that "took an active role in overseeing the Firm's mortgage unit." (Opp. at 45.) Plaintiffs allege no facts to demonstrate that Blankfein or Cohn knew, or as CEO and President, respectively, of a complex financial institution had a duty to know, about every disclosure made by the Firm on every transaction.[16] Moreover, even if Messrs. Blankfein and Cohn reasonably could be charged with such knowledge, there is no basis in law, or in the facts as alleged by Plaintiffs, to impute such knowledge to the majority of the Director Defendants.[17]

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[15] Neither this single alleged "mistake," Plaintiffs' conclusory allegation that it was just "the top of the iceberg," (Compl. ¶ 75), nor Plaintiffs' characterization of hedging and market-making practices as "unethical," is the kind of "large fraud occurring in plain sight" cited by Plaintiffs as the kind of activity of which the Director Defendants should have been aware. *See Shaev*, 2006 WL 391931, at *6 (cited in Opp. at 44).

[16] Plaintiffs erroneously contend that Messrs. Blankfein and Cohn had some special duty to oversee "conflicted employees." (Opp. at 41.) But the decision on which Plaintiffs rely, *Forsythe* v. *ESC Fund Mgmt. Co. (U.S.)*, C.A. No. 1091-VCL, 2007 Del. Ch. LEXIS 140 (Del. Ch. Oct. 9, 2007), deals with the far different situation of a general partner subject to heightened duties under a partnership agreement. *Forsythe* made clear that the standard applicable in that case differs from usual duty of loyalty cases involving "a board of directors sitting atop a command-style management structure of persons legally required to act loyally to the corporation." *Id*. at *24. There is no basis in law or in fact for Plaintiffs' conclusory statement that defendants here "creat[ed] a conflict" between the interest of Goldman Sachs managers and shareholders such that "[d]efendants had a duty to oversee such conflicted employees." (Opp. at 41.) Moreover, as defendants demonstrated in their opening brief, far from creating such a conflict, the type of incentive-based compensation at issue here provided Goldman Sachs management an interest in the profits of the enterprise and aligned defendants' interests with those of Goldman Sachs' other shareholders. (Mem. at 32-33.)

[17] Plaintiffs cite just one decision in support of this proposition, and their reliance on it is misplaced. In *Saito* v. *McCall*, C.A. No. 17132-NC, 2004 WL 3029876 (Del. Ch. Dec. 20, 2004) (cited at Opp. 45-46), plaintiffs alleged with particularity that the director defendants had learned about improper accounting practices—identifying the specific audit committee meeting at which the dollar amount of the potential discrepancy, the possibility of an SEC investigation, and the fact that an independent auditing firm had raised red flags allegedly were discussed. *Id.* at *7. Here, Plaintiffs merely assert, in conclusory fashion, that Messrs. Blankfein and Cohn knew of alleged misconduct in Goldman Sachs' mortgage unit

Plaintiffs' "red flag" allegations, although dressed up with such pejoratives as "unethical," complain principally about Goldman Sachs' weighing of, and approaches for addressing, various business risks—matters at the heart of the business judgment rule.[18] Remarkably, Plaintiffs complain that Goldman Sachs *accurately* recognized the risk of the "impending subprime mortgage market collapse" in late 2007 (Complaint ¶ 53), and that Goldman Sachs sought to hedge its mortgage-related risks and to profit from its foresight (*id.* at ¶¶ 148-49). Taking steps to protect the firm from financial loss is the antithesis of actionable conduct—it is prudent risk management.

II. THE COMPLAINT FAILS TO STATE ANY LEGALLY SUFFICIENT CLAIM.

Even if the Court determines that Plaintiffs were not obligated to comply with the pre-suit demand requirements of Ct. Ch. R. 23.1, their claims nonetheless should be dismissed under Ct. Ch. R. 12(b)(6) for failure to state a claim as to which the Court may grant relief.

A. Plaintiffs Have Failed to State a Claim Based on "Excessive" Compensation.

As discussed above, the Opposition fails to articulate why any particular employee's compensation allegedly was "excessive," let alone demonstrate that the

and ask the Court to impute that knowledge "to the entire Board." (Opp. at 45-46.) Delaware courts have refused to extend *Saito* in this manner, and Plaintiffs fail to cite any other authority in support of their logical leap. *See Desimone* v. *Barrows*, 924 A.2d 908, 943 (Del. Ch. 2007) ("*Saito* did not lay down any universally applicable rule about knowledge imputation" and refusing to extend *Saito* to impute knowledge where plaintiffs failed to allege that alleged misconduct "was the subject of regular communication in the boardroom"); *see also Rahbari* v. *Oros*, 732 F. Supp. 2d 367, 386 n.21 (S.D.N.Y. 2010) (same); *Rattner* v. *Bidzos*, C.A. No. 19700, 2003 WL 22284323, at *11 (Del. Ch. Sept. 30, 2003) (holding that directors cannot be charged with knowledge of information merely because they served on a board with a director who may have known such information).

[18] *See*, *e.g.*, Opp. at 1 ("[M]anagement was initially able to generate profits . . . by taking huge risks with the capital of shareholders to leverage its own sub-standard performance [and] sought to mitigate the consequences of such risk-taking by engaging in unethical and unlawful conduct . . . ."); *id.* at 11 ("Goldman engaged in leverage of 25%, a level that exceeded even that of . . . Lehman Brothers and Bear Stearns"); *id.* at 35 (shareholders are exposed to "losses that might materialize in future years as a result of employee risk-taking, including civil liability"); *id.* at 41 ("Goldman's senior management . . . operate[d] the firm for their own benefit by taking on additional risk" to increase their compensation).

compensation paid to all of Goldman Sachs' tens of thousands of employees was "so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration." *Brehm*, 746 A.2d at 263 (internal quotation omitted). All Plaintiffs offer is speculation and self-selected compensation metrics that they seek to substitute for the judgment of the Goldman Sachs Board. Simply put, when it comes to compensation, "'How much is too much?' is a question far better suited to the boardroom than the courtroom . . . ." *In re InfoUSA, Inc. S'holders Litig.*, 953 A.2d 963, 983 (Del. Ch. 2007). It cannot be "unconscionable" or "irrational[]" for a board to pay all of its employees, even if some shareholders second-guess total compensation levels as excessive. *Brehm*, 746 A.2d at 263.

Thus, if the Complaint is not dismissed for failure adequately to plead demand futility, Plaintiffs' waste claim should be dismissed with prejudice on the merits.

B. Plaintiffs Have Failed to State a Claim Based on Any Failure of Oversight.

As stated above, Plaintiffs have failed to state a lack-of-oversight claim because Plaintiffs concede that Goldman Sachs' Board had in place systems of oversight. Such claims also require that a plaintiff "plead bad faith by alleging with particularity that a director *knowingly* violated a fiduciary duty or failed to act in violation of a *known* duty to act, demonstrating a *conscious* disregard for her duties." *Citigroup*, 964 A.2d at 125 (emphasis added). Plaintiffs have failed to plead such failures by any defendant, let alone that they occurred with the requisite intent. Thus, if the Complaint is not dismissed for failure to plead demand futility, Plaintiffs' claim premised on a failure of oversight should be dismissed with prejudice on the merits.

CONCLUSION

For the foregoing reasons and those previously discussed in defendants' opening submissions in support of their motion, defendants respectfully request that the Court dismiss Plaintiffs' Amended Complaint in its entirety, with prejudice, and grant to defendants such other and further relief as the Court may deem just and proper.

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CERTIFICATE OF SERVICE

I hereby certify that on March 15, 2011, a copy of the foregoing was served by e-file upon the following attorney of record:

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