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UNITED STATES DISTRICT COURT  
EASTERN DISTRICT OF WASHINGTON  
AT SPOKANE

CITY OF ROSEVILLE EMPLOYEES'  
RETIREMENT SYSTEM, Individually  
and on Behalf of All Others Similarly  
Situated,

Plaintiff,

vs.

STERLING FINANCIAL  
CORPORATION, HAROLD B.  
GILKEY and DANIEL G. BYRNE,

Defendants.

No.

CLASS ACTION

COMPLAINT FOR VIOLATION OF  
THE FEDERAL SECURITIES LAWS

DEMAND FOR JURY TRIAL

## INTRODUCTION

1  
2 1. This is a securities class action on behalf of all persons who purchased or  
3 otherwise acquired the publicly traded securities of Sterling Financial Corporation  
4 (“Sterling” or the “Company”) between July 23, 2008 and January 13, 2009 (the  
5 “Class Period”), against Sterling and certain of its officers and/or directors for  
6 violations of the Securities Exchange Act of 1934 (“1934 Act”).

7 2. Sterling is the bank holding company for Sterling Savings Bank and Golf  
8 Savings Bank. Sterling Savings Bank is the largest commercial bank headquartered in  
9 the state of Washington and is one of the largest regional community banks in the  
10 western United States. It offers banking products and services, mortgage lending,  
11 construction financing and investment products to individuals, small businesses,  
12 commercial organizations and corporations. Golf Savings Bank is a savings bank  
13 focused on the origination and sale of single-family residential mortgage loans.  
14 Sterling is headquartered in Spokane, Washington.

15 3. During the Class Period, defendants issued materially false and  
16 misleading statements regarding the Company’s business and financial results.  
17 Defendants engaged in improper behavior which harmed Sterling’s investors by  
18 failing to disclose the extent of seriously delinquent commercial real estate loans and  
19 construction and land loans. The Company also failed to adequately and timely record  
20 losses for its impaired loans, causing its financial results and its Tier 1 capital ratio to  
21 be materially false. As a result of defendants’ false statements, Sterling’s stock traded  
22 at artificially inflated prices during the Class Period, reaching a high of \$14.72 per  
23 share on October 1, 2008.

24 4. Then, on January 13, 2009, Sterling issued guidance for the fourth  
25 quarter and year end 2008, announcing it anticipated reporting a massive loss for both  
26 the fourth quarter and the year ended December 31, 2008. According to Sterling, the

1 loss would be due in substantial part to an anticipated increase in its allowance for  
2 loan and lease loss reserves of approximately \$230 million and an expected goodwill  
3 impairment charge of between \$275 million to \$325 million. Sterling further  
4 announced that it would be suspending its quarterly cash dividend.

5 5. On this news, Sterling's stock collapsed \$3.05 per share to close at \$3.40  
6 per share on January 14, 2009, a one-day decline of 47% on high volume.

7 6. The true facts, which were known by the defendants but concealed from  
8 the investing public during the Class Period, were as follows:

9 (a) Defendants' assets contained hundreds of millions of dollars worth  
10 of impaired and risky securities, many of which were backed by real estate that was  
11 rapidly dropping in value and for which Sterling had failed to record adequate loan  
12 loss reserves;

13 (b) Defendants failed to properly account for Sterling's commercial  
14 real estate loans and construction and land development loans, failing to reflect  
15 impairment in the loans;

16 (c) Sterling had not adequately reserved for loan losses such that its  
17 financial statements were presented in violation of Generally Accepted Accounting  
18 Principles ("GAAP");

19 (d) Sterling had not adequately accounted for its goodwill or its  
20 deferred tax assets such that its financial statements were presented in violation of  
21 GAAP;

22 (e) Sterling had not adequately reserved for loan losses such that its  
23 Tier 1 capital was presented in violation of banking regulations; and

24 (f) The Company's capital base was not adequate enough to withstand  
25 the significant deterioration in the real estate markets and, as a result, Sterling would  
26

1 be forced to consent to a cease and desist order from the Federal Deposit Insurance  
2 Corporation (“FDIC”) directing it to raise \$300 million in capital.

3 7. Thereafter, on August 19, 2009, Sterling announced it had missed its  
4 recent dividend payment on preferred shares owned by the Treasury Department  
5 pursuant to the Treasury Department’s investment in the Company through the  
6 Troubled Asset Relief Program in December 2008.

7 8. On October 15, 2009, Sterling announced it had agreed to a cease and  
8 desist order from the FDIC. Under an agreement with the FDIC and the Washington  
9 Department of Financial Institutions, the Company agreed to decrease its  
10 nonperforming assets, related to its troubled commercial real estate and acquisition  
11 loans, land development loans and construction loans. Sterling further agreed to  
12 review and revise its allowance for loan and lease losses and remedy any deficiencies  
13 in the allowance. Additionally, Sterling agreed to increase Sterling Savings Bank’s  
14 Tier 1 Capital ratio by at least \$300 million and thereafter maintain a Tier 1 leverage  
15 ratio of not less than 10%.

16 9. Then, on October 22, 2009, Sterling issued its results for the third quarter  
17 of 2009 and nine months ending September 30, 2009, announcing another massive  
18 quarterly loss. The Company reported a net loss of \$463.7 million, compared to net  
19 income of \$5 million for the third quarter of 2008. The disastrous results were due in  
20 large part to an increase in its allowance for loan and lease losses as well as to  
21 additional charges for impaired goodwill and a valuation allowance charge against the  
22 Company’s deferred tax assets.

23 10. As a result of defendants’ false statements and omissions, Sterling’s  
24 publicly traded securities traded at artificially inflated prices during the Class Period.  
25 However, after the above revelations seeped into the market, the Company’s shares  
26

1 were hammered by massive sales, sending them down more than 76% from their Class  
2 Period high.

### 3 **JURISDICTION AND VENUE**

4 11. Jurisdiction is conferred by §27 of the 1934 Act. The claims asserted  
5 herein arise under §§10(b) and 20(a) of the 1934 Act and SEC Rule 10b-5.

6 12. Venue is proper in this District pursuant to §27 of the 1934 Act. Many of  
7 the false and misleading statements were made in or issued from this District.

8 13. Sterling's principal executive offices are located at 111 North Wall  
9 Street, Spokane, Washington.

### 10 **PARTIES**

11 14. Plaintiff City of Roseville Employees' Retirement System purchased  
12 Sterling publicly traded securities as described in the attached certification and was  
13 damaged thereby.

14 15. Defendant Sterling operates as the bank holding company for Sterling  
15 Savings Bank, which provides various banking products and services to small and  
16 medium-sized businesses, and individuals.

17 16. Defendant Gilkey co-founded Sterling. Gilkey was, at all relevant times,  
18 Chairman of the Board, Chief Executive Officer ("CEO") and President of Sterling  
19 until leaving the Company on October 19, 2009.

20 17. Defendant Daniel G. Byrne ("Byrne") is, and at all relevant times was,  
21 Executive Vice President-Finance, Chief Financial Officer ("CFO") and Assistant  
22 Secretary of Sterling.

23 18. Defendants Gilkey and Byrne (the "Individual Defendants"), because of  
24 their positions with the Company, possessed the power and authority to control the  
25 contents of Sterling's quarterly reports, press releases and presentations to securities  
26 analysts, money and portfolio managers and institutional investors, *i.e.*, the market.

1 They were provided with copies of the Company’s reports and press releases alleged  
2 herein to be misleading prior to or shortly after their issuance and had the ability and  
3 opportunity to prevent their issuance or cause them to be corrected. Because of their  
4 positions with the Company, and their access to material non-public information  
5 available to them but not to the public, the Individual Defendants knew that the  
6 adverse facts specified herein had not been disclosed to and were being concealed  
7 from the public and that the positive representations being made were then materially  
8 false and misleading. The Individual Defendants are liable for the false statements  
9 pleaded herein.

### 10 **FRAUDULENT SCHEME AND COURSE OF BUSINESS**

11 19. Defendants are liable for: (i) making false statements; or (ii) failing to  
12 disclose adverse facts known to them about Sterling. Defendants’ fraudulent scheme  
13 and course of business that operated as a fraud or deceit on purchasers of Sterling  
14 publicly traded securities was a success, as it: (i) deceived the investing public  
15 regarding Sterling’s prospects and business; (ii) artificially inflated the prices of  
16 Sterling publicly traded securities; and (iii) caused plaintiff and other members of the  
17 Class to purchase Sterling publicly traded securities at inflated prices.

### 18 **CLASS ACTION ALLEGATIONS**

19 20. Plaintiff brings this action as a class action pursuant to Rule 23 of the  
20 Federal Rules of Civil Procedure on behalf of all persons who purchased or otherwise  
21 acquired Sterling publicly traded securities during the Class Period (the “Class”).  
22 Excluded from the Class are defendants.

23 21. The members of the Class are so numerous that joinder of all members is  
24 impracticable. The disposition of their claims in a class action will provide substantial  
25 benefits to the parties and the Court. Sterling has over 52 million shares of stock  
26 outstanding, owned by hundreds if not thousands of persons.



1 products, including transaction accounts, interest and non-interest bearing checking  
2 accounts, savings accounts, money market deposit accounts, certificates of deposit  
3 accounts, and time deposits. It also provides loan products comprising commercial  
4 lending products, such as lines of credit, receivable and inventory financing,  
5 equipment loans, and permanent and construction real estate financing; multifamily  
6 residential and commercial real estate loans; one-to-four-family residential loans; and  
7 consumer loans for automobiles, boats and recreational vehicles, and lines of credit for  
8 personal use. Sterling also markets fixed income and equity products, mutual funds,  
9 fixed and variable annuities, and other financial products. The Company, through its  
10 subsidiary Golf Savings Bank, engages in the origination and sale of residential  
11 mortgage loans.

12 **DEFENDANTS' FALSE AND MISLEADING**  
13 **STATEMENTS ISSUED DURING THE CLASS PERIOD**

14 27. On July 22, 2008, Sterling issued its second quarter 2008 earnings  
15 results, in a release which stated in part:

16 Sterling Financial Corporation, a leading community bank in the  
17 western region, today announced that second-quarter 2008 earnings  
18 relative to first-quarter 2008 earnings increased as a result of a lower  
19 provision for credit losses, stable net interest margin, higher non-interest  
20 income, and improved operating efficiency. Earnings in the second  
21 quarter of 2008 were \$11.7 million, or \$0.23 per diluted share, and  
22 reflect a provision for credit losses of \$31.0 million. Earnings for the first  
23 quarter of 2008 were \$2.9 million, or \$0.06 per diluted share, and  
24 included a provision for credit losses of \$37.1 million. Earnings in the  
25 second quarter of 2007 were \$27.0 million, or \$0.52 per diluted share,  
26 and included a provision for credit losses of \$4.0 million. Earnings for  
the six months ended June 30, 2008, were \$14.6 million, or \$0.28 per  
diluted share, compared with \$49.9 million, or \$1.02 per diluted share,  
for the same period in 2007. The provision for credit losses for the first  
six months of 2008 was \$68.1 million compared with \$8.2 million for the  
first six months of 2007.

“Thanks to the focus and commitment of our employees, our core  
banking operations performed solidly in the midst of an ongoing credit  
cycle troubling the country. Our customer base remained steadfast during  
the quarter and their loyalty reflects our relationship-based, service-  
oriented Hometown Helpful(R) culture,” stated Harold B. Gilkey,  
chairman and chief executive officer.



1 average loans was 0.18% compared with 0.02% in the comparable period  
2 last year. **Management believes the allowance is adequate and**  
3 **appropriate given its current analysis of the loan portfolio and the**  
4 **relative mix and risk of loan products.** Sterling will continue to evaluate  
5 the level of allowance relative to credit conditions in each of its markets.

6 \* \* \*

## 7 Balance Sheet and Capital Management

8 As of June 30, 2008, Sterling's total assets were \$12.70 billion,  
9 compared with total assets of \$12.69 billion at March 31, 2008, and  
10 \$11.46 billion at June 30, 2007. **"Sterling's liquidity position remains**  
11 **strong,"** Mr. Gilkey stated. The total value of Sterling's cash, cash  
12 equivalents and high grade investment securities was \$2.39 billion at  
13 June 30, 2008. Sterling's investment securities provide substantial  
14 liquidity and collateral for borrowings. As of mid-July, Sterling had  
15 additional borrowing capacity of over \$700 million through the Federal  
16 Home Loan Bank of Seattle, plus access to over \$2.3 billion in additional  
17 liquidity through commercial banks and the Federal Reserve and from  
18 available securities.

19 As of June 30, 2008, Sterling's tangible book value per share was  
20 \$13.41, up from \$12.31 reported at the end of the second quarter of  
21 2007, and down from \$13.68 reported at the end of the first quarter of  
22 2008. The year-over-year increase in book value reflects the retention of  
23 earnings and the improvement in the unrealized market value of the  
24 securities portfolio, whereas the quarter-to-quarter decrease in book  
25 value reflects a decline in the unrealized market value of the securities  
26 portfolio. With respect to market volatility, **Sterling is continuing to**  
**analyze the value of goodwill related to its acquisitions to determine**  
**whether the value of goodwill has been impaired.** Sterling anticipates  
that the analysis will be completed by the end of the third quarter.  
Sterling's ratio of tangible shareholders' equity to tangible assets was  
5.71% at the end of the second quarter of 2008, compared with 5.76%  
reported at the end of the second quarter of 2007. Risk-based capital  
ratios continue to exceed the "well-capitalized" requirements. **As of**  
**quarter end, Sterling's Tier I and total risk-based capital ratio were**  
**9.6% and 10.9%, respectively, and above the regulatory minimum**  
**"well-capitalized" requirements of 6.0% and 10.0%, respectively.**

28. On this news, Sterling's stock rose \$1.88 per share, to close at \$7.76 per  
share on July 23, 2008 – a one-day increase of 31%.

29. On October 21, 2008, Sterling announced its third quarter 2008 earnings  
results in a release which stated in part:

Sterling Financial Corporation, a leading community bank in the  
western region, today announced third-quarter 2008 earnings of \$5.0  
million, or \$0.10 per diluted share, compared with third-quarter 2007

1 earnings of \$26.5 million, or \$0.51 per diluted share. Earnings for the  
2 nine months ended September 30, 2008 were \$19.5 million, or \$0.38 per  
3 diluted share, compared with earnings of \$76.4 million, or \$1.54 per  
4 diluted share, for the nine months ended September 30, 2007. Results for  
5 the third quarter of 2008 as well as for the first nine months of 2008  
6 reflect higher provisions for credit losses primarily relating to Sterling's  
7 residential construction portfolio. The provisions for credit losses for the  
8 third quarter of 2008 and the nine months of 2008 were \$37.0 million  
9 and \$105.1 million, respectively, compared with \$3.9 million and \$12.1  
10 million, respectively, for the comparable periods one year ago.

11 "Sterling's results reflect some dislocations in the Pacific  
12 Northwest economy caused by a variety of factors, including global  
13 disruptions to the financial system and the Boeing union strike. These  
14 events created a slowdown in the sale of residential product and thereby  
15 affected our borrowers and elevated our credit costs. The Pacific  
16 Northwest is insulated, but not isolated, from the broader economy. Still,  
17 the Pacific Northwest remains relatively strong," stated Harold B.  
18 Gilkey, chairman and chief executive officer.

19 "Operationally, Sterling's execution was solid. We slightly  
20 reduced the size of our balance sheet while shifting our mix of assets  
21 away from residential construction. We grew our deposits. We controlled  
22 operating costs. Our liquidity and capital positions remained strong. *Our  
23 credit administration team proactively managed loan portfolio risk. In  
24 sum, we are managing through a difficult credit cycle while  
25 maintaining a safe, sound and secure banking practice,*" said Mr.  
26 Gilkey.

\* \* \*

## Credit Quality

27 In the third quarter of 2008, Sterling recorded a \$37.0 million  
28 provision for credit losses, compared with \$31.0 million for the linked  
29 quarter and \$3.9 million for the same period a year ago. This provision  
30 stems from higher levels of classified assets, which include non-  
31 performing assets. As of September 30, 2008, classified assets were  
32 \$671.5 million, compared with \$497.5 million at June 30, 2008, and  
33 \$215.6 million at September 30, 2007. Residential construction assets  
34 continue to make up approximately two thirds of all classified assets.

35 At September 30, 2008, non-performing assets were \$436.7  
36 million, compared with \$303.4 million at June 30, 2008, and \$61.8  
37 million at September 30, 2007. Real estate owned, which is included in  
38 non-performing assets, was \$55.0 million at quarter end, compared with  
39 \$23.0 million in the linked quarter and \$3.4 million in the year-ago  
40 quarter. Real estate owned represents a key part of the process of  
41 resolving non-performing assets, in which the bank gains control of  
42 problem assets and then sets about to dispose of them in an orderly  
43 fashion.

1 Residential construction loans continue to be the main constituent  
2 of non-performing assets, representing \$316.8 million, or 73% of non-  
3 performing assets. Of the \$133.3 million increase in non-performing  
4 assets in the third-quarter 2008 over the second-quarter, residential  
5 construction made up \$75.9 million and other loan collateral types  
6 constituted \$57.4 million of the increase. Residential construction non-  
7 performing assets rose 31% over the linked quarter; the increase  
8 primarily was a result of one large relationship based in Portland.  
9 Excluding this non-performing asset, residential construction non-  
10 performing assets rose 14%. The other portion of the \$133.3 million  
11 increase in non-performing assets was associated with non-performing  
12 assets within Sterling's residential mortgage and commercial portfolios  
13 and were mainly tied to borrowers working in or associated with real  
14 estate brokerage, residential construction or the housing industry.

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"We are one year-plus into this current credit crisis. In the month  
of September, we witnessed a glimmer of recovery in the house  
marketing – a rise in the number of pending home sales in the Puget  
Sound region as well as Washington State. Nonetheless, non-performing  
assets, particularly those related to residential construction, are likely to  
remain elevated over the next several quarters. *Sterling has the capital  
reserves and earnings capacity to continue to manage through this  
difficult cycle and an excellent asset recovery team to resolve problem  
assets,*" said Mr. Gilkey. "We are fortunate to reside in one of the  
strongest regions of the country. Compared to other regions of the  
country, the Puget Sound region, our largest market, continues to  
perform relatively well. Non-performing loans related to this market  
amount to \$38.1 million, or 4% of outstanding commitments," Mr.  
Gilkey added.

\* \* \*

At September 30, 2008, the allowance for credit losses totaled  
\$183.7 million, or 1.99% of total loans, compared with \$168.7 million,  
or 1.80% of total loans, at June 30, 2008, and \$108.3 million, or 1.22%  
of total loans, at September 30, 2007. The year-to-date ratio of net  
charge-offs to average loans was 0.41% compared with 0.03% in the  
comparable period last year. *"Our year-to-date experience with  
resolving non-performing credits suggests that our actual loan loss  
content is in line with our estimated loan loss allowances,"* said Mr.  
Gilkey. *Management believes the allowance is adequate and  
appropriate given its current analysis of the loan portfolio and the  
relative mix and risk of loan products. Sterling will continue to  
evaluate the level of allowance relative to credit conditions in each of  
its markets.*

#### Balance Sheet and Capital Management

At September 30, 2008, Sterling's total assets were \$12.62 billion,  
compared with total assets of \$12.70 billion at June 30, 2008, and \$11.75  
billion at September 30, 2007. The total value of Sterling's cash, cash  
equivalents and high grade investment securities was \$2.41 billion at

1 September 30, 2008. Sterling's investment securities provide substantial  
2 liquidity and collateral for borrowings. As of September 30, 2008,  
3 Sterling had additional capacity of over \$1.3 billion through the Federal  
4 Home Loan Bank of Seattle, plus access to over \$1.8 billion in additional  
5 liquidity through the Federal Reserve, correspondent relationships and  
6 available securities. ***"Sterling's liquidity position remained strong and  
7 improved slightly relative to the second quarter of 2008.*** Sterling had no  
8 exposure to equity investments of either Fannie Mae or Freddie Mac,"  
9 Mr. Gilkey stated.

10 At September 30, 2008, Sterling's tangible book value per share  
11 was \$13.45, up from \$13.08 at the end of the third quarter of 2007, and  
12 up from \$13.41 at the end of the second quarter of 2008. The year-over-  
13 year increase in tangible book value reflects the retention of earnings and  
14 the improvement in the unrealized market value of the securities  
15 portfolio, whereas the quarter-to-quarter increase in tangible book value  
16 reflects an increase in the unrealized market value of the securities  
17 portfolio. ***During the quarter, Sterling completed its analysis of the  
18 value of goodwill as of June 30, 2008, and concluded that there was no  
19 impairment of goodwill.*** However, given market volatility, Sterling will  
20 continue to monitor its goodwill value and impairment indicators on a  
21 quarterly basis. Sterling's ratio of tangible shareholders' equity to  
22 tangible assets was 5.77% at the end of the third quarter of 2008,  
23 compared with 5.97% reported at the end of the third quarter of 2007,  
24 and 5.71% at the end of the second quarter of 2008. Risk-based capital  
25 ratios continue to exceed the "well-capitalized" requirements. Sterling's  
26 Tier I and total risk-based capital ratio were 9.7% and 11.0%,  
respectively, and above the regulatory minimum "well-capitalized"  
requirements of 6.0% and 10.0%, respectively.

27 Sterling is currently evaluating the federal government's Troubled  
28 Asset Relief Program created pursuant to the recently enacted  
29 Emergency Economic Stabilization Act, which includes legislation  
30 concerning access to capital, problem asset resolution and other items.

31 30. On November 24, 2008, Sterling issued a press release entitled "Sterling  
32 Financial Corporation to Participate in U.S. Treasury Capital Purchase Program,"  
33 which stated in part:

34 Sterling Financial Corporation, a leading community bank in the western  
35 region, today announced that it has received notification of preliminary  
36 approval from the U.S. Department of Treasury for the sale of \$303  
37 million in senior preferred stock and related warrants to the U.S.  
38 Treasury under the Capital Purchase Program of the Emergency  
39 Economic Stabilization Act of 2008.

40 Under the Capital Purchase Program, the U.S. Treasury plans to  
41 purchase up to \$250 billion of senior preferred shares on a voluntary  
42 basis from healthy U.S. financial institutions, as part of its efforts to

1 provide a firmer capital foundation for banks and to increase credit  
2 availability to businesses and consumers.

3 “The U.S. Treasury’s approval of Sterling’s participation in this  
4 voluntary program is positive affirmation of our strength and financial  
5 health,” stated Harold B. Gilkey, chairman and chief executive officer.  
6 “The investment is anticipated to increase Sterling’s total risk-based  
7 capital ratio to 13.8%, on a pro forma basis, from 11.0% at September  
8 30, 2008. The fortification of Sterling’s capital position through  
9 attractively priced capital from the U.S. Treasury enhances Sterling’s  
10 financial flexibility to make additional loans to the businesses and  
11 consumers in the communities in which we serve. We are hopeful that  
12 this program will help stabilize and accelerate recovery of the economy.”

13 The nonvoting senior preferred shares will pay a cumulative  
14 compounding dividend of 5% per year for the first five years and will  
15 reset to a rate of 9% per year after five years. The shares are callable by  
16 Sterling at par after three years and may be replaced if Sterling were to  
17 choose to repurchase them with newly raised equity capital at any time.  
18 In addition to the preferred shares, the U.S. Treasury will receive 10-year  
19 warrants entitling the Treasury to purchase shares of Sterling common  
20 stock with an approximate aggregate value equal to \$45 million or 15%  
21 of the senior preferred investment.

22 31. Then, on January 13, 2009, Sterling issued a press release entitled  
23 “Sterling Financial Corporation of Spokane, Washington, Provides Fourth-Quarter  
24 2008 Guidance,” which stated in part:

25 Sterling Financial Corporation, a leading community bank in the western  
26 region, announced today that it expects to recognize a non-cash charge of  
\$275 million to \$325 million related to the impairment of goodwill. This  
non-cash charge does not affect Sterling’s liquidity, operations or  
regulatory capital ratios. In addition, Sterling plans to record a fourth-  
quarter provision for credit losses of approximately \$230 million for the  
quarter ended December 31, 2008. The increase in provision relates to  
worsening economic conditions, the continued stress on real estate  
values, increasing levels of both classified and non-performing assets  
and higher net charge-offs. As a result of the higher provision for credit  
losses and the non-cash charge for impairment of goodwill, Sterling  
anticipates that it will report a net loss for both the fourth quarter and for  
the year ended December 31, 2008.

27 Sterling’s board of directors has decided to suspend its quarterly  
28 cash dividend payable on its common stock until economic conditions  
29 improve. In December 2008, Sterling strengthened its capital position by  
30 raising \$303 million through the sale of preferred shares and related  
31 warrants to the U.S. Department of Treasury as part of the Treasury’s  
32 Capital Purchase Program. The actions that Sterling has taken to  
strengthen and preserve its capital base are expected to enable Sterling to  
exceed the regulatory minimum “well capitalized” capital ratios. Sterling

1 anticipates that its total risk-based capital ratio will be above 12% as of  
2 December 31, 2008. The anticipated impairment charge related to  
3 goodwill does not affect the regulatory capital ratios of Sterling or of its  
4 subsidiary banks because goodwill is excluded from calculations  
governing regulatory capital. Sterling and its subsidiary banks therefore  
are anticipated to remain “well capitalized” under the regulatory  
requirements.

5 In November 2008, Sterling took steps to protect customer  
6 deposits through its participation in the Federal Deposit Insurance  
7 Corporation’s (FDIC’s) voluntary expanded insurance program, which  
8 provides, without charge to depositors, full guarantee on all non-interest  
9 bearing transaction accounts held by any depositor, regardless of dollar  
amount. In addition, to protect interest bearing transaction accounts, the  
basic limit on federal deposit insurance coverage increased from  
\$100,000 to \$250,000 per depositor under the Emergency Economic  
Stabilization Act enacted in October 2008.

10 32. On this news, Sterling’s stock collapsed \$3.05 per share to close at \$3.40  
11 per share on January 14, 2009, a one-day decline of 47% on high volume.

12 33. The true facts, which were known by the defendants but concealed from  
13 the investing public during the Class Period, were as follows:

14 (a) Defendants’ assets contained hundreds of millions of dollars worth  
15 of impaired and risky securities, many of which were backed by real estate that was  
16 rapidly dropping in value and for which Sterling had failed to record adequate loan  
17 loss reserves;

18 (b) Defendants failed to properly account for Sterling’s commercial  
19 real estate loans and construction and land development loans, failing to reflect  
20 impairment in the loans;

21 (c) Sterling had not adequately reserved for loan losses such that its  
22 financial statements were presented in violation of GAAP;

23 (d) Sterling had not adequately accounted for its goodwill or its  
24 deferred tax assets such that its financial statements were presented in violation of  
25 GAAP;

1 (e) Sterling had not adequately reserved for loan losses such that its  
2 Tier 1 capital was presented in violation of banking regulations; and

3 (f) The Company's capital base was not adequate enough to withstand  
4 the significant deterioration in the real estate markets and, as a result, Sterling would  
5 be forced to consent to a cease and desist order from the FDIC directing it to raise  
6 \$300 million in capital.

### 7 POST CLASS PERIOD EVENTS

8 34. On January 27, 2009, Sterling issued a press release entitled "Sterling  
9 Financial Corporation of Spokane, Washington, Announces 2008 Earnings Results –  
10 Total Risk-Based Capital Near Record Levels Liquidity Position Remains Strong,"  
11 which stated in part:

12 Sterling Financial Corporation, a leading community bank in the western  
13 region, today released earnings results for the quarter and year ended  
14 December 31, 2008. As previously announced, results for the quarter and  
15 full year include a non-cash charge of \$223.8 million related to the  
16 impairment of goodwill and a provision for credit losses of \$228.5  
17 million. Sterling determined that the value of its goodwill had become  
18 impaired based on a number of factors including the sustained and  
19 protracted decline in its stock price and market capitalization, similar in  
20 magnitude to other publicly traded financial institutions. The increase in  
21 provision relates to worsening economic conditions, the continued stress  
22 on real estate values, increasing levels of both classified and non-  
23 performing assets, as well as the recognition of higher net charge-offs  
24 and the requirement for additional allowances for credit losses caused by  
25 a change in determining the fair market value of impaired loans.

26 35. On August 19, 2009, Sterling issued a press release entitled "Sterling  
Financial Corporation of Spokane, Washington, Announces Deferral of Interest  
Payments on Trust Preferred Securities and Suspension of Cash Dividend Payments  
on Preferred Stock," which stated in part:

Sterling Financial Corporation today announced that, as part of its  
ongoing strategy to manage through the current economic cycle, it has  
deferred regularly scheduled interest payments on its outstanding junior  
subordinated notes relating to its trust preferred securities. Sterling also  
announced the deferral of regular quarterly cash dividend payments on  
its \$303 million in preferred stock. Sterling is allowed to defer payments

1 of interest on the junior subordinated notes for up to 20 consecutive  
2 quarterly periods without default.

3 “Today’s actions are consistent with our strategy of maintaining a  
4 solid balance sheet and a strong liquidity position. We continue to focus  
5 on our core banking business and our Hometown Helpful(R) customer  
6 service. These are all essential elements of realizing our long-term  
7 growth potential,” said Harold B. Gilkey, chairman and chief executive  
8 officer of Sterling Financial Corporation. “Sterling management has  
9 been actively pursuing a strategy to strengthen its balance sheet by  
10 reducing non-performing assets and improving certain loan  
11 concentrations. We believe our actions in this challenging economic  
12 environment are in the best long-term interest of our shareholders and  
13 customers.”

14 Sterling estimates that the deferral of interest payments on the  
15 junior subordinated notes and the suspension of cash dividend payments  
16 on its preferred stock will preserve approximately \$5.7 million per  
17 quarter in cash. At June 30, 2009, all of Sterling’s capital ratios were  
18 above the “well capitalized” minimums under regulatory guidelines, with  
19 Sterling’s total risk-based capital ratio at 13.0% and its tier 1 leverage  
20 ratio at 8.7%.

21 36. On October 14, 2009, the Company announced that defendant Gilkey had  
22 resigned from his positions as Chairman of the Board, CEO and President of the  
23 Company.

24 37. On October 15, 2009, Sterling issued a press release entitled “Sterling  
25 Financial Corporation of Spokane, Washington, Announces Agreement with  
26 Regulator,” which stated in part:

27 Sterling Financial Corporation today announced that its subsidiary,  
28 Sterling Savings Bank, has entered into an agreement with its regulators  
29 to continue taking actions to strengthen its financial condition and  
30 operations.

31 William L. Eisenhart, chairman of Sterling’s board of directors,  
32 stated, “Sterling has been working closely with its regulators since the  
33 start of this economic cycle to ensure that we are maintaining safe and  
34 sound banking practices. Our agreement formalizes steps that already are  
35 underway and that we and our regulators feel are necessary to maintain  
36 Sterling’s financial health, and its ability to provide high levels of service  
37 to our customers and the communities we serve throughout the Pacific  
38 Northwest.”

39 The agreement commits Sterling’s principal banking subsidiary,  
40 Sterling Savings Bank, to continue taking actions relating to its capital  
41 position, asset quality, liquidity and management oversight. It is known

1 as a Stipulation and Consent to the Issuance of an Order to Cease and  
2 Desist, and was entered into with the Federal Deposit Insurance  
3 Corporation (“FDIC”) and Washington Department of Financial  
4 Institutions.

5 Under the agreement, Sterling Savings Bank is required, among  
6 other things, to achieve and maintain a Tier I leverage capital ratio of not  
7 less than 10% by December 15, 2009. Sterling continues to work with its  
8 financial advisor, Sandler O’Neill + Partners, L.P., to evaluate options  
9 for raising additional capital. In July, Sterling filed a shelf registration  
10 statement with the Securities and Exchange Commission to provide the  
11 ability to raise up to \$500 million over the next three years and, in  
12 September, it received shareholder approval to increase the number of  
13 authorized shares of Sterling common stock to facilitate the raising of  
14 capital.

15 The agreement also commits Sterling to reducing its level of  
16 classified and non-performing loans and other assets. Sterling’s board  
17 and management have launched initiatives to reduce the proportion of its  
18 loans and other assets that are classified non-performing, and to improve  
19 its credit practices going forward.

20 To lead the efforts to improve credit quality and strengthen  
21 oversight of the bank, the board named a new generation of executive  
22 leadership. J. Gregory “Greg” Seibly was named acting president and  
23 acting chief executive officer of Sterling Financial Corporation and  
24 acting chief executive officer of Sterling Savings Bank. Ezra A. Eckhardt  
25 was named acting chief operating officer of Sterling Financial  
26 Corporation and acting president of Sterling Savings Bank, and  
continues as its chief operating officer.

Customer deposit accounts and non-classified loans are unaffected  
by the agreement with regulators. Deposits remain fully covered by  
FDIC insurance to at least \$250,000 per depositor. In addition, non-  
interest bearing transaction accounts and qualified NOW Checking  
accounts are fully guaranteed by the FDIC for an unlimited amount of  
coverage under the FDIC’s Transaction Account Guarantee (TAG)  
program, in which Sterling is a participant. The coverage under the TAG  
program is in addition to, and separate from, the coverage available  
under the FDIC’s general deposit insurance protection.

“Our core deposits have been growing in response to our  
relationship-driven deposit strategy. This is helping us to maintain a  
strong liquidity position,” said Mr. Seibly. “As the Pacific Northwest’s  
largest community bank, Sterling is committed to ensuring that it has the  
financial strength and resources to serve our customers over the long  
term.”

1           38.    Then, on October 22, 2009, Sterling issued a press release entitled  
2 “Sterling Financial Corporation of Spokane, Washington, Announces Third-Quarter  
3 2009 Results,” which stated in part:

4           Sterling Financial Corporation, the bank holding company of Sterling  
5 Savings Bank and Golf Savings Bank, today announced results for the  
6 quarter and the nine months ended September 30, 2009.

7           The net loss attributable to Sterling’s common shareholders was  
8 \$463.7 million, or \$8.93 per common share, compared with net income  
9 in last year’s third quarter of \$5.0 million or \$0.10 per common share.

10           The net loss was \$459.4 million before the accrual of \$4.3 million  
11 in cumulative preferred dividends associated with the U.S. Treasury’s  
12 Capital Purchase Program. The loss for the quarter reflects the following:

- 13           •     a non-cash charge of \$227.6 million to account for the  
14           impairment of the remaining goodwill, which primarily  
15           relates to banks that Sterling acquired between 1998 and  
16           2007;
- 17           •     a provision of \$195.5 million to increase the allowance for  
18           loan losses; and,
- 19           •     a non-cash valuation allowance of \$143.0 million  
20           established against its deferred tax asset.

21           39.    As a result of defendants’ false statements, Sterling’s stock traded at  
22 inflated levels during the Class Period. However, after the above revelations seeped  
23 into the market, the Company’s shares were hammered by massive sales, sending  
24 them down more than 76% from their Class Period high.  
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1                   **GAAP PROVISIONS VIOLATED BY DEFENDANTS IN**  
2                   **ACCOUNTING FOR CREDIT AND LOAN LOSS RESERVES<sup>1</sup>**

3           40.    The two central accounting items related to defendants’ understatement  
4 of Sterling’s loan loss reserves during the Class Period were the Reserve or Allowance  
5 for Loan and Lease Losses (“ALLL”) on the balance sheet (which reduces assets), and  
6 the corresponding Loan Loss Provision, which is a direct reduction of pretax earnings  
7 on Sterling’s income statement. The accounting for these items is governed by  
8 specific GAAP provisions, SEC rules and Office of Thrift Supervision guidance.  
9 Because there is a plethora of guidance on the subject, defendants were well informed  
10 of how to account for the ALLL and Loan Loss Provision during the Class Period.  
11 The rules that defendants violated are set forth below.

12           41.    Section 9.19 of the Audit and Accounting Guide for Depository and  
13 Lending Institutions provides that financial institutions are responsible for  
14 *“[m]aintain[ing] adequate controls to ensure the ALLL is consistently determined in*  
15 *accordance with GAAP, stated policies and procedures, and relevant supervisory*  
16 *guidance.”*

17           42.    Section 9.04 of the same Audit and Accounting Guide for Depository and  
18 Lending Institutions also provides: *“Management is responsible* for estimating credit  
19 losses. . . . [M]anagement must make careful judgments about collectibility and  
20 estimates of losses. *Management’s judgments should consider micro- and macro-*  
21 *economic factors; past, current, and anticipated events based on facts in evidence at*  
22 *the balance-sheet date; and realistic courses of action it expects to take.”*

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23           <sup>1</sup>       GAAP are those principles recognized by the accounting profession as the conventions, rules and procedures  
24 necessary to define accepted accounting practices at a particular time. SEC Regulation S-X (17 C.F.R. §210.4-01(a)(1))  
25 states that financial statements filed with the SEC which are not prepared in compliance with GAAP are presumed to be  
26 misleading and inaccurate, despite footnote or other disclosure. Regulation S-X requires that interim financial  
statements, such as quarterly financial statements, must also comply with GAAP, with the exception that interim  
financial statements need not include disclosures which would be duplicative of disclosures accompanying annual  
financial statements. 17 C.F.R. §210.10-01(a).

1           43. Under GAAP, a loss contingency is an existing condition, situation, or set  
2 of circumstances involving uncertainty as to possible loss. See FASB Statement of  
3 Financial Accounting Standards (“SFAS”) No. 5, ¶1.<sup>2</sup> The collectability of mortgage  
4 loans is an example of a loss contingency. GAAP requires that an estimated loss from  
5 a loss contingency be accrued by a charge to income if both of the following  
6 conditions are met: (a) *information available prior to issuance of the financial*  
7 *statements indicates that it is probable that an asset had been impaired or a liability*  
8 *had been incurred at the date of the financial statements; and (b) the amount of loss*  
9 *can be reasonably estimated.* See SFAS No. 5, ¶8.

10           44. Even if no accrual is made for a loss contingency because one or both of  
11 the above conditions of SFAS No. 5 are not met, or if an exposure to loss exists in  
12 excess of the amount accrued, defendants were still required to disclose the  
13 contingency when there is at least a “*reasonable possibility*” that a loss or an  
14 additional loss may have been incurred.<sup>3</sup> SFAS No. 5, ¶10. The disclosure shall  
15 indicate the nature of the contingency and shall give an estimate of the possible loss or  
16 range of loss or state that such an estimate cannot be made. See SFAS No. 5, ¶10.

17           45. Nearly two-thirds of Sterling’s loan portfolio consisted of commercial  
18 real estate loans and construction and land development loans. Defendants caused  
19 Sterling to provide insufficient provision for loan losses during the Class Period. The  
20 Company’s insufficient provisions for loan losses is shown by the large charges the  
21 Company recorded in the fourth quarter of 2008 and in the third quarter of 2009.

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23           <sup>2</sup> On June 30, 2009, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 168, *The FASB*  
24 *Accounting Standards Codification*<sup>TM</sup> (“ASC”), which will become the source of authoritative U.S. accounting and  
25 reporting standards for nongovernmental entities, in addition to guidance issued by the SEC. These allegations use the  
26 historical references to U.S. GAAP, as such references existed during the Class Period.

<sup>3</sup> GAAP defines “reasonably possible” as “[t]he chance of the future event or events occurring is more than  
remote but less than likely.” SFAS No. 5, ¶3.



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**COUNT I**

**For Violation of §10(b) of the 1934 Act and Rule 10b-5  
Against All Defendants**

51. Plaintiff incorporates ¶¶1-50 by reference.

52. During the Class Period, defendants disseminated or approved the false statements specified above, which they knew or deliberately disregarded were misleading in that they contained misrepresentations and failed to disclose material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

53. Defendants violated §10(b) of the 1934 Act and Rule 10b-5 in that they:

- (a) employed devices, schemes and artifices to defraud;
- (b) made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
- (c) engaged in acts, practices and a course of business that operated as a fraud or deceit upon plaintiff and others similarly situated in connection with their purchases of Sterling publicly traded securities during the Class Period.

54. Plaintiff and the Class have suffered damages in that, in reliance on the integrity of the market, they paid artificially inflated prices for Sterling publicly traded securities. Plaintiff and the Class would not have purchased Sterling publicly traded securities at the prices they paid, or at all, if they had been aware that the market prices had been artificially and falsely inflated by defendants' misleading statements.

**COUNT II**

**For Violation of §20(a) of the 1934 Act  
Against All Defendants**

55. Plaintiff incorporates ¶¶1-54 by reference.



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