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Goldman May Face Backlash for Staying Mum on Probe

By Steve Eder and Matthew Goldstein

Freshly branded a "vampire squid," Goldman Sachs Group Inc last summer contended with a backlash over its ballooning bonus pool and a controversy over the "special sauce" that made its high-frequency trading operation go.

At the same time, another concern quietly lurked in the background.

In August, the U.S. Securities and Exchange Commission notified Goldman through an official "Wells Notice" that it was facing civil liability in the Abacus collateralized debt obligation case. Goldman did not disclose its SEC quandary to investors until charges were filed against the company on Friday.

SEC rules mandate that companies must report material events to shareholders within 10 days.

Wells Notices often are disclosed because companies want to avoid to shareholder lawsuits. When the news of the charges against Goldman broke on Friday, shares tumbled more than 12 percent.

"We disclose legal and regulatory matters as required," Goldman spokesman Samuel Robinson said. "There is no obligation to disclose receipt of a Wells

Notice, which can have many potential outcomes -- or none."

But some investors, not surprisingly, are angry and looking to sue Goldman, said Jacob Zamansky, a plaintiff's lawyer, who said he's been contacted by a number of clients about potential suits against the dominant Wall Street bank.

Zamansky called the failure to disclose the Wells Notice "highly significant."

"It should have been disclosed and most firms on the Street do, in fact, disclose these," Zamansky said. "Look at the effect this has had. A case by the SEC is clearly material to their business. I'm sure this isn't the only deal where they have problems."

"Material"

On Friday, the SEC charged Goldman with hiding from institutional investors the involvement of a prominent hedge fund manager in helping it structure a subprime mortgage debt product that he was betting against.

Goldman vowed to vigorously defend itself against the charges and denied that it had structured a portfolio that was designed to lose money, claiming that Goldman itself had invested in the equity portion of the deal.

Ironically, months before the SEC filed its charges, lawyers for Goldman had tried to persuade regulators that there was no need to disclose the hedge fund's involvement because it wasn't "material." That, of course, is much the same argument Goldman is making now about its own decision not to disclose the Wells Notice.

The SEC, as a general rule, does not tell companies when to disclose the receipt of a Wells Notice. The decision is left to the company to decide whether it is something investors would want to know about.

Some companies disclose Wells Notices in regulatory filings shortly after being notified by the SEC. For instance, Dell Inc, Bank of America Corp and American International Group Inc have all disclosed Wells Notices that they or their employees have received.

Jill Fisch, a professor at the University of Pennsylvania Law School, said there's no bright line on when companies report Wells Notices.

"There isn't a standard approach to this," Fisch said. "The real question is how big an impact is this case likely to have on Goldman. You can't necessarily judge that by the market reaction because the market reaction may be an overreaction or a perception that this is the tip of the iceberg."

In determining whether or not to disclose a Wells Notice, some companies will only do so if the regulatory action implicates a division that's responsible for either 10 percent of its assets or revenues.

In the case of Goldman, the Abacus CDO deal, at most, put the company on the

hook for paying about \$1 billion in damages. In 2009, Goldman's net income was about \$12 billion.

A Busy Summer

When Goldman received the Wells Notice, it was already fending off other PR hits.

There was a backlash against its pay practices and the fact that it had already set aside billions of dollars to pay its employees, soon after taxpayers had committed hundreds of billions to rescue the industry.

Goldman also faced questions about its transactions with American International Group, the giant insurer at the heart of the meltdown -- and how Goldman benefited from AIG's rescue.

Further, Goldman's high-frequency trading models came under scrutiny as one of its former employees was charged with stealing its secret computer codes. The saga led to a new line of questions about whether Goldman had special advantages in its trading operations.

And, of course, Rolling Stone writer Matt Taibbi famously described the investment bank as "a great vampire squid wrapped around the face of humanity" -- a nickname that has stuck as a punch line.

Some Goldman investors and clients, already incensed at the SEC's allegations, say the company is likely to be full of excuses when it eventually fields questions from investors.

"Of course. they have an obligation to report material facts," said Michael Vogelzang, president of investment firm Boston Advisors, which owns shares of Goldman Sachs, "But in a very real way, it is Goldman doing what they do."