

## SEC Faces Challenges With Goldman Case

- By [KARA SCANNELL](#)  
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The Securities and Exchange Commission unearthed significant evidence against Goldman Sachs Group Inc. in its fraud case filed Friday, but the agency still faces challenges in persuading a jury should the case go to trial, lawyers not involved in the case said.

The SEC's suit against Goldman is the agency's biggest assault on a Wall Street firm in a matter stemming from the credit crisis. A successful outcome for the SEC could go a long way in repairing its reputation, which was damaged by its failure to discover Bernard Madoff's Ponzi scheme and other shortcomings that emerged during the crisis.

The SEC's case against Goldman and a vice president at the firm, Fabrice Tourre, hangs on a single critical contention. The SEC says Goldman sold investors a product linked to the performance of certain mortgages without telling them that a hedge fund betting on the mortgages' demise helped design the product.

Several lawyers not involved in the case said the evidence, as laid out in the SEC's complaint, is deep enough to support the civil fraud charges. "From the complaint, it looks pretty strong," said Jill Fisch, a law professor at the University of Pennsylvania. "It's a test case in terms of the SEC going forward both for whether they're successful and, if they settle, will it be a meaningful penalty," she said.

The SEC has the tricky job of showing that Goldman was reckless in deceiving investors about the hedge fund's role, said Peter Huang, a securities law professor at Temple University. "If you were buying something, you should care about the fact that the person who was picking the things you were buying was actually betting against them," he said. "That's the part that wasn't disclosed."

Goldman Sachs denied the allegations and said it was "disappointed" the SEC filed a lawsuit "related to a single transaction in the face of an extensive record which establishes that the accusations are unfounded in law and fact." A lawyer for Mr. Tourre didn't respond to an email seeking comment.

One line of defense, hinted at in Goldman's initial statements, is that the sophisticated investors buying the products should have known these transactions inherently involve investors betting on the success and failure of the underlying mortgages. Lawyers who reviewed the SEC complaint agreed that the products themselves weren't illegal.

That puts the onus on the SEC to demonstrate that the hedge fund, Paulson & Co., played a key role in designing the product and that Goldman had an obligation to disclose this role. Paulson wasn't charged.

**"They're going to have to show...that [Goldman] knew that Paulson was not only shortselling it but he had a big role in collecting weakest possible mortgages to bet against it," said Bradley Simon, a white collar criminal defense lawyer and partner at Simon & Partners LLP.**

The complaint alleges that Goldman intentionally hid Paulson's role and deceived investors into thinking that an independent mortgage-analysis firm, ACA Management LLC, was responsible for designing the product.

The specifics of what ACA knew about Paulson's involvement in creating the product and what Goldman then told investors will be important to establishing the SEC's case, several attorneys said.

Outside lawyers said the complexity of the transaction is one hurdle if the case goes to trial because jurors may have difficulty understanding what happened.

Complex financial products like the one sold by Goldman have gotten a bad reputation since the financial meltdown, Mr. Huang said. "They're essentially like gambling."

A jury trial will become public relations war, said Mark Britton, a former SEC staff attorney and founder of the lawyer rating Web site Avvo.com. "To the extent Goldman gets to a jury, they're going to attempt to assemble jurors that are very conservative and are not going to like the government meddling in capital markets," Britton said. "They're going to attempt to sell the story that this is politics and Goldman's being hung out to dry."

On the other hand, Goldman has been unpopular in the last year because it was one of the recipients of government bailout funds and it has paid large bonuses to its executives, Britton said.

The SEC has been looking at mortgage-related products created and sold by the major Wall Street firms for over 18 months, said people familiar with the matter.

It has already brought several cases. Earlier this month, it alleged that a mutual-fund manager at Morgan Keegan & Co., a Memphis unit of Regions Financial Corp., deliberately inflated the value of subprime securities to hide losses. Last year it charged Countrywide Financial Corp. co-founder Angelo Mozilo with misleading investors about the health of the company's mortgages. Both defendants are fighting the charges.

The string of contested high-profile cases, with Goldman the most prominent, shows the SEC, which normally settles most allegations, is willing to be aggressive. But it also could strain the agency's resources and test its mettle in the courtroom if many of them go to trial.

Several attorneys reviewing the Goldman case said they see Friday's complaint as the opening salvo in a legal process that could lead to further charges against the company or other individuals.