SEC Split on Goldman Case

3-2 Vote to Sue Could Politicize Landmark Action; Key Panel at Firm Gave OK to Deal

BY KARA SCANNELL

The Securities and Exchange Commission decided to sue Goldman Sachs Group Inc. over the objections of two Republican commissioners, suggesting an unusual split at the agency that could politicize one of its most prominent cases in years.

People familiar with the matter said the five-member commission held a lengthy meeting Wednesday to debate the civil-fraud charges against Goldman, and ultimately voted 3-2 in favor of pushing forward. The charges were filed Friday.

Normally the agency prefers to have unanimous support when bringing enforcement actions against the firms it regulates. Word of the SEC split could exacerbate partisan tensions in Washington over the Obama administration's proposed financial-regulatory overhaul.

John Nester, an SEC spokesman, declined to comment.

The SEC alleges that in a 2007 deal, Goldman deceived clients by selling mortgage securities secretly designed by hedge-fund king John Paulson to profit on a plunge in housing prices.

That deal was quickly approved by a panel of about a dozen senior Goldman executives, including people who helped to manage the firm’s mortgage, credit and legal operations, people familiar with the situation told The Wall Street Journal.

One part of Goldman’s defense has been that it lost $90 million, but the SEC alleges the deal was an attempt to manipulate the housing market.

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million in the transaction, arguing that it "surely didn't wish to structure an investment in which we lost money." In fact, the firm never intended to buy any of the deal; it just couldn't sell all the instruments to other investors—hence the loss, says people familiar with the matter.

Goldman, which denies any wrongdoing, sought to downplay the case Monday. In a voice-mail message to employees, Chief Executive Lloyd C. Blankfein described the core of the SEC case as an "allegation that one employee misled two professional investors." Fabrice Tourre, the 31-year-old Goldman trader at the center of the suit, went on paid leave "with no end date," the firm said.

Goldman's board met Monday and remains firmly behind Mr. Blankfein, according to people familiar with the matter.

On Tuesday, SEC Chairman Mary Schapiro is likely to get a grilling over the internal dissent when she appears before the House Financial Services Committee for scheduled testimony.

People familiar with the vote said Ms. Schapiro—a registered independent—joined two Democrats on the commission, Elisse Walter and Luis Aguilar, in supporting the fraud case against Goldman. The two Republican commissioners, Kathleen Casey and Troy Paredes, were opposed, they said. The commissioners didn't respond to repeated requests for comment.

In recent years, splits on high-profile enforcement cases have been rare. Ms. Schapiro, appointed by President Obama, told The Journal in January that the agency in her tenure has voted unanimously "north of 90%" of the time on enforcement cases. The agency has split more frequently on the rules it passes to regulate the industry and corporate disclosures.

"It's really important on enforcement matters to try to get the agency all reading from the same page," said Harvey Pitt, a former Republican SEC chairman. As a technical matter, he said, it won't affect the court case, but he noted that judges aren't immune from what's happening elsewhere. "Nobody ever wants to be pursuing an enforcement case that can be attacked on anything but the merits."

On key regulatory moves, partisan squabbling has broken out this year several times. In late January, Ms. Casey and Mr. Paredes protested when Ms. Schapiro pushed through guidance encouraging companies to disclose the effects of climate change on their business.

The two Republicans protested in a 3-2 vote in February approving curbs on short selling, a way for investors to bet on a stock's decline. Mr. Paredes said the rule, a response to speculative activity that drove down some shares in the financial crisis, was "rooted in conjecture." There have been skirmishes in past Wall Street cases over the input of SEC commissioners.

In 1994, the SEC filed civil administrative proceedings against three former executives at Kidder Peabody Group Inc. after a bond scandal at the firm. Two of the executives argued that the SEC improperly filed the case without a quorum of commissioners. It was the first time in SEC history that it filed a major civil administrative case with a vote of just two of its five commissioners. An SEC administrative law judge rejected the argument and the case proceeded.

Democrats have been citing the SEC's action against Goldman to press the case for their financial overhaul. Republicans said the Democrats' plan for new financial rules would only make it easier for big banks that run into trouble to secure government bailouts in the future.

In a letter to be sent Tuesday to the SEC, Rep. Darrell Issa (R., Calif.) plans to ask the agency why the Goldman case was brought as the financial-regulation bill was pending, according to Mr. Issa's spokesman. "Democrats are desperate to cast Wall Street as the villain so they won't be held accountable for the country's economic condition," Mr. Issa said.

The White House said Monday it had no advance notice of the Goldman action. Spokesman Robert Gibbs said the case for an overhaul rested on Wall Street's actions over years that contributed to the crisis, not the specifics of the Goldman case.

Meanwhile, two Democratic members of Congress urged the SEC to force Goldman to return funds it got from American International Group Inc. if the insurer sold default protection based on fraudulent conduct by Goldman, according to a letter they circulated on Capitol Hill. AIG had insured about $6 billion of Goldman's "Abacus" CDOs.

AIG has been considering potential claims against Goldman and other Wall Street banks over soured mortgage securities that led to heavy losses, according to a person familiar with the matter. Even before Friday's lawsuit against Goldman was filed, government-controlled AIG had been scrutinizing mortgage asset pools and securitizations it previously bought or insured for any evidence that the structures were created or sold fraudulently, this person said. No cases are imminent, the person added.
Goldman Links Cut Both Ways

Politicians Seek to Tar by Association, But Bank and Paulson Gave Across Aisle

BY BRODY MULLINS
AND JEAN SPENCER

John Paulson, the man at the center of the government’s case against Goldman Sachs Group Inc., has held political fund-raising events in recent weeks for top politicians of both political parties.

According to people familiar with the events, Mr. P.- elson organized one of the events on behalf of the Republican National Committee. It featured RNC Chairman Michael Steele and Republican presidential hopeful Mitt Romney. The other was for Democratic Sen. Charles Schumer of New York.

Mr. Paulson’s bipartisan support for politicians points to the difficulty both parties face as they try to use the case against Goldman for political gain. Goldman was charged last week by the Securities and Exchange Commission with civil fraud relating to its trading in mortgage-related investments.

Mr. Paulson wasn’t accused of wrongdoing. A spokesman said: “John Paulson supports a variety of candidates in both political parties based on keeping the United States the financial and economic capital of the world.”

A spokesman for the RNC and Mr. Schumer declined to comment. A spokesman for Mr. Rom ney didn’t respond to a request for comment.

Wall Street and Goldman have been leading sources of campaign cash for both Republicans and Democrats, according to the nonpartisan Center for Responsive Politics. Since 1989, Goldman’s political action committee and its employee ranked second among corporate donors to AT&T Corp. in total campaign donations — $31.6 million.

Nearly two-thirds of the money has gone to Democrats, making Goldman the largest corporate source of campaign donations to Democrats. The firm is the fourth-largest donor among companies to Republicans.

On Monday, Goldman was at the center of political tumult, as politicians sought to smear opponents with association with the firm. The National Republican Congressional Committee dubbed Goldman’s political donations “Democrats’ Goldman Parachute.”

Service Employees International Union Secretary-Treasurer Anna Burger called Republicans the “Goldman-Owned Party,” citing GOP opposition to Democrats’ overhaul of financial regulation.

House Republican leaders said Monday that President Barack Obama “has raised more money from Goldman Sachs than any other human in the history of the United States of America.”

Mr. Obama collected nearly $1 million from Goldman employees during his 2008 presidential campaign. The next-biggest recipient of Goldman-related contributions was former Democratic Sen. Hillary Clinton, with about $500,000 total.

Some senior House Republicans have also benefited from Goldman donations. Virginia Rep. Eric Cantor, the No. 2 House Republican, received the maximum $10,000 from Goldman’s PAC, according to campaign records. A spokesman for Mr. Cantor declined to comment.

Hari Sevugan, a Democratic National Committee spokesman speaking for Mr. Obama, said the Goldman donations weren’t infl unencing Mr. Obama’s behavior, pointing out that the president was leading the charge for new regulations on Wall Street.

Outside Washington, the issue is reverberating in key races for Congress. In Illinois, Democrat Alexi Giannoulias, who is running for Mr. Obama’s old Senate seat, challenged the Republican candidate, Rep. Mark Kirk, to return the donations he has received from Goldman employees.

Mr. Kirk decided to “err on the side of caution” and returned the $21,600 in contributions he received from Goldman employees, said a Kirk spokesman, “until we get to the bottom of what happened.”

So far during the 2010 congressional elections, Democrats dominate the list of top recipients of donations from Goldman’s PAC and employees.

Other leading recipients include Alabama Sen. Richard Shelby ($35,000), top Republican on the Senate Banking Committee; New York Democratic Sen. Kirsten Gillibrand ($24,000); and New York Democratic Rep. Scott Murphy ($23,000). The lawmakers’ offices didn’t respond to requests for comment.

Robert Dold, a Republican running for a House seat in Illinois, said he would either return his $7,000 from Goldman or donate it to charity.

“We will certainly not be using the money, and we are calling on the president to return his million dollars as well,” Mr. Dold said.
Goldman in High Places

The revolving door between Goldman Sachs and government goes back to the administration of President Franklin D. Roosevelt. Some of those who made the switch from executive positions to political ones.

**AT GOLDMAN**

- **Henry M. Paulson Jr.**
  - Chairman and chief executive officer, 1999–2006
- **Neel Kashkari**
  - At Goldman, 2002–06; led IT Security Investment Banking practice
- **Joshua Bolten**
  - Executive Director for Legal and Government Affairs in London, 1994–99
- **Reuben Jeffery Jr.**
- **Stephen Friedman**
  - Joined Goldman in 1966; co-chairman or chairman, 1990–94

**IN GOVERNMENT**

- **Bill Dudley**
  - Treasury Secretary under President George W. Bush
- **Gary Gensler**
  - Ran the $700 billion Troubled Asset Relief Program until May 2009
- **Robert Rubin**
  - White House chief of staff to George W. Bush, 2006–09
- **Jon Corzine**
  - Chairman, Commodity Futures Trading Commission, 2005–07
- **Sidney J. Weinberg**
  - Chairman of the board of the Federal Reserve Bank of New York in 2008 and 2009

**AT GOLDMAN**

- **Bill Dudley**
  - Joined Goldman in 1986; partner and managing director until 2007
- **Gary Gensler**
  - Joined Goldman in 1979; co-head of finance, 1995–97
- **Robert Rubin**
  - Joined Goldman in 1966; co-chairman and co-senior partner, 1990–92
- **Jon Corzine**
  - Joined Goldman in 1975; chairman and chief executive, 1994–99
- **Sidney J. Weinberg**
  - Joined in 1907 as a janitor’s assistant; senior partner, 1930–69

**IN GOVERNMENT**

- **Bill Dudley**
  - Federal Reserve Bank of New York president since January 2009
- **Gary Gensler**
  - Chairman, Commodity Futures Trading Commission since May 2009
- **Robert Rubin**
  - Treasury secretary, 1995–99, under President Bill Clinton
- **Jon Corzine**
  - Governor of New Jersey, 2006–10; formerly U.S. senator
- **SIDNEY J. WEINBERG**
  - Vice chairman, War Production Board, Roosevelt and Truman administrations

Photos: Paulson, Weinberg (Getty Images); Jeffery, Friedman, Dudley (Agence France-Presse/Getty Images); Rubin (Associated Press); Kudinsk/L (Bloomberg News); Gensler, Corzine (Reuters); Bolten (Bloomberg)
The SEC’s Impeccable Timing

The Securities and Exchange Commission fraud case against Goldman Sachs may be settled before it ever sees a courtroom. Yet intentionally or not, the SEC has already secured at least one victory in the court of public opinion. Last Friday, the same day that the government unexpectedly announced its Goldman lawsuit, the SEC’s inspector general released his exhaustive, 151-page report on the agency’s failure to investigate alleged fraudster R. Allen Stanford. Mr. Stanford was indicted last June for operating a Ponzi scheme that bilked investors out of $8 billion. He has pleaded not guilty.

Guess which of these two stories was pushed to the back pages? The SEC did its part by publishing the Stanford report so deep in its Web site that more than a few of our readers had trouble finding it. Yesterday, the SEC management’s response to the report was available on the agency’s homepage, yet it provided no links to the report itself.

Little wonder. The report is damming for an SEC that wants the public to believe it has turned the corner after the Bernie Madoff disaster. The commission has made young Fabrice Tourre of Goldman Sachs a household name for his debatable disclosures to institutional investors. But many individual investors will be more interested in learning the story of Spencer Barasch. He’s the SEC enforcement official who sat on various referrals to investigate Allen Stanford and then, after leaving the SEC, performed legal work for... Allen Stanford.

In its own way, the Stanford calamity is arguably worse than the SEC’s Madoff bungle. In the Madoff case, passionate outsider Harry Markopolos could find no one at the SEC who took the time to understand the scam, cared enough and had enough authority to shut down the fraud. In the Stanford case, we see numerous SEC insiders over many years urging—at times begging—the enforcement staff to take action, to no avail.

The examination staff at the SEC’s district office in Fort Worth, Texas reviewed the Stanford Group’s operations in 1997, concluded that its sale of certificates of deposit likely constituted a Ponzi scheme, and referred the matter to SEC enforcement staff. Mr. Stanford kept on selling his seemingly too-good-to-be-true CDs, so SEC examiners investigated again in 1998, 2002 and 2004. Each time, they concluded that the Stanford operation was a probable Ponzi scheme and urged SEC action. Each time, the enforcement staff failed to act.

Along the way, SEC enforcers also ignored warnings from the daughter of an elderly investor in the Stanford scheme, the Texas State Securities Board, an anonymous insider in the Stanford operation, and U.S. Customs, which suspected that the Stanford organization was laundering money. The SEC at times would open preliminary investigations. When the Stanford Group declined to provide information, the inquiry would end.

Particularly tragic is that almost all of the $8 billion that Mr. Stanford collected from investors was gathered after the SEC’s first round of inquiries, so if SEC enforcers had acted on the first referral from their colleagues, this alleged fraud would be measured in millions of dollars, not billions. Later, some investors increased their investments with Stanford Group after they learned that the SEC had investigated in 2005 and took no action. They viewed it as a clean bill of health.

In the wake of its Goldman lawsuit, the SEC is being hailed for returning to a “tough” enforcement line, but this is deceiving. The contrast between the SEC inspector general’s report on Stanford and the zeal of the SEC’s pursuit of Goldman Sachs is far more revealing about why the agency fails to stop genuine fraudsters.

While taking testimony and conducting interviews with dozens of agency staffers on Stanford, SEC IG David Kotz asked the enforcement staff how it could possibly have failed to prosecute someone who was believed by so many others to be running a fraud. The staff told him that senior SEC management did not favor the pursuit of Ponzi schemes and other frauds that were difficult to investigate and time-consuming to prosecute. He was also told that management favored “quick hits” and “Wall Street” cases.

This makes perfect sense when you think about the political incentives. Why do the painstaking work of tracking down actual criminals when you can score favorable headlines with a drive-by lawsuit against a large public company that will have a strong incentive to settle quickly?

In other words, the SEC is a dreadful failure in fulfilling its core mission of protecting individual investors, as the Stanford and Madoff cases show. But the SEC is very good atailing politically correct targets like Goldman years after the fact on charges that have little or nothing to do with the investing public. On the Goldman case, by the way, the news broke yesterday that the SEC commissioners split 3-2 on whether to bring the lawsuit—a rare partisan split on such a prominent case and further evidence of its thin legal basis.

In the cases of Stanford and Madoff, thousands of small investors lost their life savings. In the case of Goldman, some masters of the financial universe lost money on what they knew was a calculated gamble. Which did more societal harm?