SOUTHERN DISTRICT OF NEW YORK JUDGE REJECTS CLAIMS ALLEGING A DUTY TO DISCLOSE SEC WELLS NOTICES

July 3, 2012

To Our Clients and Friends:

Judge Paul Crotty of the U.S. District Court for the Southern District of New York recently held that Goldman Sachs & Co. did not have a duty to publicly disclose the receipt of a Wells Notice from the Securities and Exchange Commission ("SEC"). Prior to this decision, no court had ever been asked to consider disclosure obligations with respect to Wells Notices. Going forward, this decision may inform companies' consideration of whether and when to publicly disclose receipt of a Wells Notice.

The case, *Richman v. Goldman Sachs Group, Inc.*, centered on allegations by class action plaintiffs against Goldman relating to the firm's role in a synthetic collateralized debt obligation ("CDO") called ABACUS 2007 AC-1 ("Abacus"). In January 2009, Goldman's SEC filings disclosed ongoing governmental investigations related to the Abacus transaction. Between July 2009 and January 2010, the SEC issued Wells Notices to Goldman and two Goldman employees involved in the Abacus transaction, notifying them that Enforcement Division staff "intend[ed] to recommend an enforcement action." The SEC filed a complaint against Goldman and one of its employees in April 2010, which Goldman settled for $550 million in July 2010. Plaintiffs alleged that Goldman's failure to disclose its receipt of the Wells Notices was an actionable omission under Section 10(b) and Rule 10b-5 of the Exchange Act, and that Goldman had an affirmative legal obligation to disclose its receipt of the Wells Notices under applicable regulations.

Ruling on Goldman's motion to dismiss, Judge Crotty held that Goldman did not have a duty under Section 10(b) or applicable SEC regulations to disclose its receipt of the Wells Notices and dismissed plaintiffs' claims. In reaching this conclusion, Judge Crotty examined whether the Wells Notices were required to be disclosed either as a result of an affirmative legal obligation or out of a duty to prevent Goldman's existing disclosures about the SEC's investigation from being materially inaccurate or incomplete. Focusing his analysis on the intent of a Wells Notice, which he noted "[a]t best,…indicates not litigation but only the desire of the Enforcement staff to move forward, which it has no power to effectuate," Judge Crotty concluded that "[t]his contingency need not be disclosed" to prevent Goldman's existing disclosures of an SEC investigation from being materially misleading. With respect to affirmative disclosure requirements under applicable SEC rules, the court explained that a company's duty to disclose

under these requirements is not triggered until "the regulatory investigation matures to the point where litigation is apparent and substantially certain to occur." Finally, although Judge Crotty found that Goldman had failed to disclose the receipt of the Wells Notices as required by certain Financial Industry Regulatory Authority ("FINRA") rules, the absence of a private right of action for violations of these rules "cautioned against allowing securities fraud claims to be predicated solely on violations" of them.

THE COURT'S ANALYSIS

Judge Crotty's analysis of Goldman's disclosure obligations began with an examination of the significance of Wells Notices. A Wells Notice, named for John A. Wells, chair of the SEC committee that first proposed this procedure, is an internal procedure at the SEC in which the staff advises the subject of an SEC investigation that it is considering asking the SEC's Commissioners to authorize the filing of a lawsuit or administrative proceeding and the grounds the staff believes justify its recommendation. Under the SEC's Wells procedures, the respondent then has the option to make a "Wells Submission" explaining why the Commissioners should not follow the staff's recommendation. In his ruling, Judge Crotty explained that a Wells Notice may indicate that the SEC staff is considering recommending charges, but that, because "staff advice is not authoritative," a Wells Notice "does not necessarily indicate that charges will be filed" and "is well short of litigation." Following these premises, Judge Crotty then examined, and rejected, each of plaintiffs' claims concerning Goldman's nondisclosure.

First, Judge Crotty rejected plaintiffs' claim that Goldman had a duty to disclose its receipt of the Wells Notices in order to prevent its prior disclosures concerning ongoing governmental investigations from being materially misleading. Prior to receipt of the Wells Notices to it and its employees, Goldman had disclosed the existence of the SEC's and other government agencies' inquiries into its CDO practices. Although recognizing that when a company "chooses to speak" it has a "duty to be both accurate and complete," Judge Crotty disagreed with plaintiffs' assertion that this duty required disclosure of the Wells Notices, explaining that "revealing one fact about a subject does not trigger a duty to reveal all facts on the subject, so long as 'what was revealed would not be so incomplete as to mislead.'" Because "[t]he federal securities laws 'do not require a company to accuse itself of wrongdoing'" or to make disclosures predicting that as the outcome of investigations, the Wells Notices did not render Goldman's existing disclosures materially misleading or incomplete. On the contrary, according to Judge Crotty, the Wells Notices merely indicated that "governmental investigations were indeed ongoing," consistent with Goldman's prior disclosures, and did not indicate that litigation was "substantially certain to occur." Judge Crotty noted that, although plaintiffs would like to be

made aware of Wells Notices, "'a corporation is not required to disclose a fact merely because a reasonable investor would very much like to know that fact.'"

Second, while expressing skepticism that a regulatory reporting duty under Regulation S-K would even create a disclosure duty under Section 10(b), Judge Crotty rejected plaintiffs' claim that Goldman had a duty under Item 103 of Regulation S-K to disclose its receipt of Wells Notices. Item 103 requires companies to disclose legal proceedings "known to be contemplated by government authorities." After referring back to its analysis of the preliminary nature of SEC staff recommendations in contrast to authoritative agency action, the court found that Goldman did not have any explicit or implicit duty to disclose its receipt of Wells Notices under Item 103, reiterating that Goldman was not required to make such disclosures until "litigation is apparent and substantially certain to occur." The court also noted that although Goldman had violated regulations requiring disclosure of Wells Notices to FINRA, the absence of a private right of action for violations of FINRA's rules prevented plaintiffs from using such a violation as a basis for a securities fraud claim.

THE ULTIMATE IMPLICATION ON DISCLOSURE DECISIONS IS STILL UNCERTAIN

The Richman decision suggests that companies may have some flexibility in determining whether and when to disclose receipt of a Wells Notice. However, the ultimate implications of Judge Crotty's opinion on the disclosure determinations by companies and their counsel remain uncertain. Even under Judge Crotty's analysis, such a determination must be made based on whether the Wells Notice is consistent with the content of the existing disclosures of the SEC investigation. Importantly, Judge Crotty's opinion does not hold that Wells Notices are immaterial – just that there was no duty for Goldman to disclose them in this case, so companies and company insiders with knowledge of Wells Notices must still be mindful of potential insider trading and Regulation FD issues arising from the possession, use or selective disclosure of potentially material non-public information. Finally, given that Judge Crotty is the first to consider the disclosure obligations surrounding Wells Notices, it is possible that this decision may inspire increased attention and litigation, as well as varying interpretations, concerning this issue. Consequently, companies and counsel for companies faced with a Wells Notice should continue to consider the advisability of disclosure in light of their particular facts and circumstances.

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