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 INSIDE
WEEKEND
INVESTOR
Pages 47-51

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Goldman Told to Pay Bayou Fund Creditors

BY SUSANNE CRAIG

Goldman Sachs Group Inc. was ordered to pay \$20.6 million, the largest arbitration award levied against the securities firm, to unsecured creditors of Bayou Group LLC who accused Goldman of ignoring signs of fraud at the hedge-fund firm.

Bayou collapsed in 2005, and the firm's former chief executive, Samuel Israel III, is serving a 20-year prison term for fraud. He pleaded guilty to misrepresenting the value of Bayou's funds and defrauding clients out of more than \$400 million.

Goldman cleared trades for the Connecticut firm before it collapsed. In 2008, Bayou's unsecured creditors' committee filed an arbitration claim against two Goldman units.

"Through either gross negligence or a willful choice to ignore the signs of fraud, [Goldman] failed to diligently investigate the red flags it was made aware of, to contact Bayou's auditors to request additional information, or to alert the appropriate authorities of what it had learned," lawyers for the committee alleged.

A three-person Financial Industry Regulatory Authority arbitration panel didn't provide an explanation for its ruling. A Goldman spokesman said the panel didn't conclude that the firm committed any wrongdoing or violated any rules.

In its response to the initial arbitration filing, Goldman said the \$20.5 million represents money that was fraudulently transferred among Bayou accounts and was never in Goldman's possession. Clearing operations typically maintain client records and send out trade confirmations, often earning big

fees in return.

The Goldman spokesman said the New York company is "disappointed with the award and is exploring its options." Unlike court decisions, it is extremely hard to overturn arbitration awards because courts can't review the facts in an arbitration case. Courts are allowed to reverse such awards only for exceptional reasons, such as finding that an arbitrator acted improperly.

"This is a big victory for the victims," said Ross Intelisano, a partner at New York law firm Rich & Intelisano LLP who represented the Bayou creditors.

The largest previous arbitration award against Goldman was \$2.8 million in 1994, according to Securities Arbitration Commentator, a Maplewood, N.J., newsletter that tracks arbitration cases. The Bayou ruling also is the sixth-largest arbitration award to any customer of a Wall Street firm, the newsletter said.

Winning damages from clearing firms is especially difficult because firms are required to spell out their duties in advance, often limiting their liability to only those functions. In its response to the arbitration filing, Goldman said the law "does not require clearing firms or prime brokers to monitor the suitability of the transactions they process or to investigate their account holders." Imposing such a standard "would slow commerce, raise costs and imperil financial markets," the firm said.

Separately, the Financial Crisis Inquiry Commission said Goldman President and Chief Operating Officer Gary D. Cohn and Chief Financial Officer David Viniar will testify at a hearing next week to examine the role of derivatives in the crisis.