Wells Fargo Charged With Fraud in Video Game Start-Up Case.

Wells Fargo has been accused of fraud over its role in underwriting a $75 million municipal bond deal for a video game company in Rhode Island that eventually went bankrupt, leaving taxpayers on the hook for the debt.

On Monday, the Securities and Exchange Commission charged Wells Fargo and the state agency that issued the bonds on behalf of 38 Studios, the now defunct video game start-up, with failing to disclose to investors the company's true financial picture.

The state agency had agreed to borrow the money in the tax-exempt municipal market and then lend most of the proceeds to 38 Studios, whose chairman and majority shareholder was the former Red Sox pitching ace Curt Schilling.

By lending money to a private company, owned by a local sports hero, state officials had hoped to stimulate jobs and lure other businesses to relocate to Rhode Island, which had been hit particularly hard by the recession.

But neither the state agency nor bankers at Wells Fargo disclosed in the bond offering documents that 38 Studios faced a funding shortfall even after it had received the bond proceeds.

Unable to pay off the debt, 38 Studios declared bankruptcy, sticking Rhode Island taxpayers with the bill. The bonds carried the state's "moral obligation" to repay them in the event that 38 Studios could not. Although such an obligation stopped short of an explicit requirement, the state has chosen to pay the debt — which totals about $90 million, including interest — for fear of damaging Rhode Island's credit rating.

The debacle set off years of hand-wringing and recriminations in Rhode Island. But the S.E.C.'s lawsuit, filed in the Federal District Court in Providence on Monday, is the first time that Wells Fargo's role in the bond deal has been exposed in such detail.

Wells Fargo had been hired by the Rhode Island Economic Development Corporation to underwrite the tax-exempt bonds in 2010. But the S.E.C. said Wells Fargo also cut a "side deal" with 38 Studios, which agreed to pay the bank an additional $400,000 if the bond deal closed. The side deal was never disclosed to the bond investors, the regulator said.

That side deal enabled the bank to receive twice as much money from the bond deal as was detailed in the official offering documents.

In a statement, the S.E.C. said the San Francisco-based bank failed to inform potential bond investors of the full extent of its economic interests in ensuring that the deal closed.

"An underwriter's 'skin in the game' is material information to investors," LeeAnn Ghazil Gaunt, the head of the S.E.C. enforcement division's municipal securities and public pensions unit, said in a statement. A Wells Fargo spokesman said the bank “disputes the S.E.C.’s allegations in connection with the placement of these municipal bonds.”

A spokeswoman for the economic development agency, now the Rhode Island Commerce Corporation, said in a statement that the agency had filed lawsuits against some of its former employees and Wells Fargo in connection with the bond deal.

“The corporation will continue to work toward its goals of recouping money for Rhode Island and holding the defendants in the Commerce Corporation’s lawsuit accountable,” the spokeswoman said.

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