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Horseshoes and Hand Grenades: The Dodd-Frank Act's (Almost) Attack on Credit Rating Agencies

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NOTE

HORSESHOES AND HAND GRENADES: THE DODD-FRANK ACT'S (ALMOST) ATTACK ON CREDIT RATING AGENCIES

I. INTRODUCTION

The economic crisis[1] that culminated in panic in 2008 has brought both Wall Street and Main Street to their knees.[2] Three of the largest Wall Street investment banks collapsed in a span of six months.[3] Housing prices in the United States dropped by an average of 18.5% in twenty major cities by the end of November 2008.[4] By year-end 2008,

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1. The "economic crisis" referred to throughout this Note spans from 2008 to present, but there were signs of weaknesses in the financial markets as early as the summer of 2007. *See* Kevin Warsh, Governor, Bd. of Governors of the Fed. Reserve Sys., Speech at the Council of Institutional Investors 2009 Spring Meeting: The Panic of 2008 (Apr. 6, 2009), http://federalreserve.gov/newsevents/speech/warsh20090406a.htm ("[The panic of 2008] manifested itself in the summer of 2007. Asset-backed commercial paper markets seized up in the United States and abroad. Commercial banks lost confidence in each other, putting pressure on overnight London interbank offered rates.").

2. *See* David Anderson & Sarah Hodges, *Credit Crisis Litigation: An Overview of Issues and Outcomes*, BANKING & FIN. SERVS. POL'Y REP., June 2009, at 1, 1 (discussing the collapse and acquisition of Bear Stearns by JPMorgan Chase in March 2008, the seizure of IndyMac Bank—one of the nation's largest savings and loans banks—by the federal government, and the rescue of Fannie Mae and Freddie Mac, which at the time guaranteed or owned approximately half of the country's mortgages).

3. *See* Susanne Craig et al., *AIG, Lehman Shock Hits World Markets*, WALL ST. J., Sept. 16, 2008, at A1 (explaining the impact on the global markets because of the rushed sale of Merrill Lynch & Co. and the bankruptcy filing of Lehman Brothers Holding Inc.); Robin Sidel et al., *J.P. Morgan Buys Bear in Fire Sale, As Fed Widens Credit to Avert Crisis*, WALL ST. J., Mar. 17, 2008, at A1 (describing the "fire-sale" of Bear Stearns).

4. *U.S. Housing Prices Down 18.5%, NYC Almost 10%*, BROWNSTONER (Feb. 25, 2009, 9:00 AM), http://www.brownstoner.com/brownstoner/archives/2009/02/us_housing_pric.php ("Property values in the 20 biggest U.S. cities fell an average of 18.5 percent in the year end[ing] November 2008, bringing house prices down almost 30 percent and back to late-2003 levels."). *See also* Kevin Quealy, *Home Prices in Selected Cities*, N.Y. TIMES (Dec. 4, 2008), http://www.nytimes.com/interactive/2008/12/04/business/economy/HOUSING_PRICES_GRAPHIC.html (providing the Standard & Poor's/Case-Shiller twenty-city housing index).

the unemployment rate had reached 7.2%, a 2.3% increase from year-end 2007, and a 2.7% increase from year-end 2006.[5]

The crisis prompted the federal government into action. In 2008, the Troubled Asset Relief Program ("TARP") was signed into law and permitted the U.S. Treasury to purchase or insure the assets of financial institutions.[6] Also in 2008, the federal government nationalized home-mortgage giants Fannie Mae ("Fannie") and Freddie Mac ("Freddie").[7]

While such drastic measures were implemented during the Bush administration, likewise, the Obama administration took action to curtail the faltering economy. In February 2009, Congress enacted and President Barak Obama signed into law the American Recovery and Reinvestment Act ("ARRA"),[8] a $787 billion economic stimulus plan that provided tax relief to both small businesses and individuals, and expanded unemployment and welfare benefits.[9] On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act" or the "Dodd-Frank Act")[10] into law. The Dodd-Frank Act is the most sweeping financial regulation passed in recent history and reflects the most substantial change to financial regulation since the 1930s.[11] The Dodd-Frank Act affects virtually all financial institutions, both large and small,[12] and while few

5. BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, USDL 09-0004, THE EMPLOYMENT SITUATION: DECEMBER 2008, at 1-3 (2009) (reporting the unemployment rate at 7.2% in December 2008); *see* BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, USDL 08-0013, THE EMPLOYMENT SITUATION: DECEMBER 2007, at 1-2 (2008) (reporting the unemployment rate at 5.0% in December 2007); BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, USDL 07-0003, THE EMPLOYMENT SITUATION: DECEMBER 2006, at 1-2 (2007) (reporting the unemployment rate at 4.5% in December 2006).

6. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 101(a)(1), 122 Stat. 3765, 3767.

7. *See, e.g.*, James R. Hagerty et al., *U.S. Seizes Mortgage Giants: Government Ousts CEOs of Fannie, Freddie; Promises Up to $200 Billion in Capital*, WALL ST. J., Sept. 8, 2008, at A1 ("[T]he U.S. government seized two of the nation's largest financial companies, taking direct responsibility for [Fannie and Freddie] that provide funding for around three-quarters of new home mortgages.").

8. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115.

9. *The Recovery Act*, RECOVERY.GOV, http://www.recovery.gov/About/Pages/The_Act.aspx (last visited Nov. 11, 2011). In 2011, the expenditure figures for ARRA were increased to $840 billion to conform to President Obama's budget and Congressional Budget Office changes made since the passage of the act in 2009. *Id.*

10. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

11. *Financial Services Reform Alert: Dodd Frank Next Steps . . .*, K&L GATES (Aug. 16, 2010), http://www.klgates.com/dodd-frank-next-steps-08-16-2010/.

12. *Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Enacted into Law on July 21, 2010*, DAVIS POLK, i (July 21, 2010), http://www.davispolk.com/files/Publication/efb94428-9911-4472-b5dd-006e9c6185bb/Presentation/PublicationAttachment/efd835f6-2014-4a48-832d-00aa2a4e3fdd/070910_Financial_Reform_Summary.pdf.

provisions of the Act are effective upon enactment,[13] some of the regulations will begin to affect the marketplace and litigants immediately.[14]

Blame for the economic crisis has been placed primarily on the broad shoulders of private sector actors, public sector regulators,[15] and inadequate regulation.[16] Included in the category of such private sector actors are credit rating agencies or nationally recognized statistical rating organizations ("NRSROs").[17] The criticism of credit rating agencies is not a new phenomenon,[18] but the cause of action created against credit

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13. *Id. See also* Dodd-Frank Wall Street Reform and Consumer Protection Act sec. 932(a)(8), § 15E(p)(1)(A), 124 Stat. at 1877 (establishing the Office of Credit Ratings to administer the rules that the Securities and Exchange Commission ("S.E.C.") will establish regarding credit rating agency regulation). The legislation leaves many regulations up to the agencies that will enforce provisions of the Act; thus, until the agencies adopt rules related to the various regulations, parts of the Act will not go into effect immediately. *See* DAVIS POLK, *supra* note 12, at i.

14. *See* DAVIS POLK, *supra* note 12, at i (explaining both the immediate and long-term impact of the Act and that the Act was designed to become effective in stages).

15. *See* Dale Ledbetter, *The Subprime Mortgage Meltdown: Who, What, Where and Why . . . Investigations & Litigation*, *in* UNDERSTANDING THE SUB-PRIME DEBACLE, at 39 (PLI Corporate Law & Practice, Course Handbook Ser. No. 15783, 2007) (arguing that Wall Street underwriters played a significant role in growing the subprime market and "abus[ed] borrowers and investors"). *See generally* J. Scott Colesanti, *Laws, Sausages, and Bailouts: Testing the Populist View of the Causes of the Economic Crisis*, 4 BROOK. J. CORP. FIN. & COM. L. 175 (2010) [hereinafter *Laws, Sausages, and Bailouts*] (providing an analysis of the various public sector actors that contributed to the economic crisis).

16. FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES xviii, *available at* http://www.gpoaccess.gov/fcic/fcic.pdf (last visited Nov. 11, 2011) (concluding that financial regulators failed and contributed to the instability of the financial markets). The Financial Crisis Inquiry "Commission was established as part of the Fraud Enforcement and Recovery Act[, Pub. L. No. 111-21 (2009),] passed by Congress and signed by the President in May 2009." *About the Commission*, FIN. CRISIS INQUIRY COMM'N, http://www.fcic.gov/about (last visited Nov. 11, 2011). The Financial Crisis Inquiry Commission was responsible for examining the causes of the economic crisis. *Id.*

17. John C. Coffee, Jr., *Ratings Reform: The Good, the Bad, and the Ugly; A Policy Primer on Proposed, Pending and Possible Credit Rating Reforms* 2 (Ctr. for Law & Econ. Studies, Columbia Law Sch. Law & Econ. Working Paper No. 359, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1650802 ("Broad consensus exists that inflated credit ratings and conflict-ridden rating processes played a significant role in exacerbating the 2008 financial crisis."). This Note will refer to credit rating agencies as both credit rating agencies and "NRSROs," although technically there is a distinction between the two entities. NRSROs are credit rating agencies that have registered with the S.E.C. as per the requirements outlined in Section 15E of the Securities Exchange Act of 1934. U.S. SEC. & EXCH. COMM'N, SUMMARY REPORT OF ISSUES IDENTIFIED IN THE COMMISSION STAFF'S EXAMINATIONS OF SELECT CREDIT RATING AGENCIES 4 (2008), *available at* http://www.sec.gov/news/studies/2008/craexamination070808.pdf [hereinafter SUMMARY REPORT OF CREDIT RATING AGENCIES]. The major three credit rating agencies, Moody's Investor Services, Inc. ("Moody's"), Standard & Poor's Ratings Services ("S & P"), and Fitch Ratings, Ltd. ("Fitch"), registered as NRSROs with the S.E.C. in September 2007. *Id.* at 1.

18. *See, e.g.*, Theresa Nagy, Note, *Credit Rating Agencies and the First Amendment: Applying Constitutional Journalistic Protections to Subprime Mortgage Litigation*, 94 MINN. L. REV. 140,

rating agencies in the Act is extraordinary. Specifically, Sections 931 to 939H of the Act address the regulation of credit rating agencies.[19] Section 939G of the Act repeals Securities and Exchange Commission ("S.E.C.") Rule 436(g) ("Rule 436(g)"),[20] which provided that ratings assigned by NRSROs were not part of the registration statement submitted by issuers under the Securities Act of 1933 (the "Securities Act").[21] Because security ratings made by credit rating agencies were not included in registration statements, the agencies were not subject to liability under Section 11 of the Securities Act.[22] Historically, cases brought against credit rating agencies have been dismissed because of the exemption under Rule 436(g) or First Amendment defenses.[23]

The Dodd-Frank Act created a new cause of action against credit rating agencies, and while a bold change in the face of historical attempts to shield credit rating agencies from liability,[24] it still leaves litigants in a position to overcome several hurdles. Specifically, while litigants will not be required to plead loss causation under Section 11,[25] credit rating agencies will be permitted to use the *absence* of loss causation as an affirmative defense.[26] Additionally, the judiciary has

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140, 145 (2009) (quoting Representative Henry A. Waxman's statement that "[t]he story of the credit-rating agencies is the story of a colossal failure" and explaining that the failure of credit rating agencies has "spurred public outrage, spawned numerous lawsuits, and led to new regulations" (footnotes omitted) (internal quotation marks omitted)); Coffee, *supra* note 17, at 2.

19. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 931–939H, 124 Stat. 1376, 1872-90 (2010).

20. *Id.* § 939G, 124 Stat. at 1890 ("Rule 436(g), promulgated by the Securities and Exchange Commission under the Securities Act of 1933, shall have no force or effect.").

21. 17 C.F.R. § 230.436(g)(1) (2011), *repealed by* Dodd-Frank Wall Street Reform and Consumer Protection Act § 939G, 124 Stat. at 1890. Rule 436(g) previously exempted credit rating agencies from including in registration statements "the security rating assigned to a class of debt securities, a class of convertible debt securities, or a class of preferred stock." *Id.*

22. *See* Securities Act of 1933, 15 U.S.C. § 77k (2006) (describing the civil liabilities associated with filing a false registration statement and specifically creating liability if the registration statement "contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading").

23. *See* Blair A. Nicholas & Ian D. Berg, *Credit Rating Agencies: Out of Control and in Need of Reform*, SEC. LITIG. & REG.: ANDREWS LITIG. REP., June 30, 2009, at 1, 5, *available at* http://www.blbglaw.com/misc_files/SCL1504_Commentary_Nicholas.pdf ("[A]ttempts to litigate around the Section 11 exemption . . . have been generally unsuccessful and have created even greater protections for the rating agencies through judicial precedent."). *See also infra* Part VI.A.2.

24. *See infra* Part VI.A.

25. *See, e.g.*, Iowa Pub. Emps.' Ret. Sys. v. MF Global, Ltd., 620 F.3d 137, 141 (2d Cir. 2010) ("To prevail on a § 11 . . . claim, a plaintiff must show that the relevant communication either misstated or omitted a material fact.").

26. *See, e.g.*, *In re* Merrill Lynch & Co. Research Reports Sec. Litig., 289 F. Supp. 2d 416, 421 (S.D.N.Y. 2003) (holding that "harm suffered by the plaintiffs was not caused by any alleged fraud of the defendants; rather, it was caused by the direct intervention of the crash of the internet bubble in the market for which the defendants were not responsible").

previously resisted attempts to permit private causes of action even in light of Congress's intent to create such causes of action.[27] As a result, the seemingly aggressive attempt by Congress to reign in credit rating agencies may fail to make a dent.

This Note addresses the potential effect of the newly-created cause of action against credit rating agencies attributable to the Dodd-Frank Act's repeal of Rule 436(g). This Note will also address the potential (un)success of such claims in light of the loss causation requirement for securities actions exemplified by the litigation brought after the "Global Settlement."[28] Part II of this Note explains the economic crisis and political environment leading up to the passage of the Act. Part II also describes the federal government's response to the economic crisis, the passage of the Dodd-Frank Act, and the potential success of current attempts to repeal the legislation.

Part III describes credit rating agencies, the role credit rating agencies played in the economic downturn, and the reasons why these agencies were historically exempt from liability under Section 11 of the Securities Act. Additionally, Part III of this Note details the provisions of the Dodd-Frank Act that relate to the regulation of credit rating agencies as well as the policy justifications for holding credit rating agencies liable in light of the economic crisis.

Further, Part IV of this Note provides a brief explanation of the nature of securities litigation and private causes of action under the federal securities laws. Part IV also details the impact of loss causation in causes of action brought under Section 11 of the Securities Act. Part V details the circumstances surrounding the research analyst and investment banking conflict of interest litigation that occurred after the "Global Settlement." Additionally, Part V explains the significance of loss causation in "Global Settlement" litigation. A review of the "Global Settlement" is necessary in order to understand the similarities of the litigation brought during that era and the future litigation that will be brought as a result of the newly created cause of action against credit rating agencies in the Dodd-Frank Act.

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27. *See, e.g.*, J. Scott Colesanti, *The Private Securities Litigation Reform Act of 1995: Did the "Rushed Debate" Really Spell the End of Securities Claims and RICO?*, 26 SEC. REG. L.J. 139, 156 (1998) [hereinafter *The "Rushed Debate"*] ("[W]hether holding that Congress did not contemplate certain matters or simply did not speak clearly, courts have refused to dismiss pending [Racketeer Influenced and Corrupt Organization Act of 1971 ("RICO")] claims based solely upon their reading of the RICO Amendment.").

28. As discussed *infra* Part V.A., the "Global Settlement" was the culmination of a joint investigation of various regulators into the conflicts of interest surrounding research analysts and investment bankers at brokerage firms.

Part VI details previous attempts by investors to hold credit rating agencies liable prior to the passage of the Dodd-Frank Act, including the types of claims brought by plaintiffs and the typical defenses that were raised by credit rating agencies. Part VI also examines future attempts to hold credit rating agencies liable after the Dodd-Frank Act and describes current litigation involving credit rating agencies. Part VI also briefly describes measures taken by credit rating agencies against requirements imposed by the Dodd-Frank Act. Part VII summarizes the issues with the newly created cause of action and proposes an amendment to Section 11 of the Securities Act that would better serve the consumer protection purpose of the Dodd-Frank Act.

II. THE ECONOMIC CRISIS

In order to understand the underpinnings of the economic crisis that have devastated the U.S. economy,[29] one must understand the investment vehicles at the heart of the crisis. Section A of this Part explains the role that subprime mortgages and the resulting collateralized debt obligations played in the economic decline. Section B will describe the federal government's response to the economic crisis. Section C details the passage of the Dodd-Frank Act and the purpose behind the legislation. For up-to-date commentary on the legislation, Section D describes efforts to repeal the Dodd-Frank Act.

A. *Subprime Mortgage Crisis: The Crisis of Credit*

The subprime mortgage debacle that is central to the current economic crisis began in the summer of 2007.[30] A subprime loan or mortgage is a loan made to a borrower who has poor credit and would be disqualified from prime or near-prime mortgages.[31] Subprime mortgages became significant because the loans were bundled and sold as structured products called collateralized debt obligations ("CDOs").[32] The creation of a structured product begins with the formation of a

29. *See* Warsh, *supra* note 1.

30. Markus K. Brunnermeier, *Deciphering the Liquidity and Credit Crunch 2007–2008*, J. ECON. PERSP., Winter 2009, at 77, 82-83 (discussing that while the increase in subprime mortgage defaults was noticed in February 2007, it was not until June and July 2007 that the credit market began to react).

31. Ledbetter, *supra* note 15, at 39; *Subprime Mortgage*, INVESTOPEDIA, http://www.investopedia.com/terms/s/subprime_mortgage.asp (last visited Nov. 11, 2011).

32. Brunnermeier, *supra* note 30, at 77-78 (discussing in detail the shift by banks from the "traditional banking model" to the "originate and distribute" model that led to banks offloading risk by creating structured investments such as CDOs (internal quotation marks omitted)).

portfolio of investments such as mortgages, other loans, or bonds.[33] Once the portfolios are created, the portfolios are sliced into "tranches."[34] The tranches are rated by credit rating agencies and then resold to different investors based on risk tolerance and differences in credit quality.[35] The structure of CDOs permitted many institutional investors to circumvent regulatory requirements and to hold assets they would have been prevented from purchasing.[36]

Equally significant was that the subprime mortgages were bundled and sold to government-sponsored enterprises ("GSEs") such as Fannie and Freddie.[37] Investors purchasing securities issued by Fannie and Freddie (who had purchased the subprime mortgage bundles or CDOs) mistakenly believed that the investments were guaranteed because the government would not permit Fannie and Freddie to become insolvent.[38] The availability of CDOs to investors that had previously not invested in such products and the impression that some of these investments were guaranteed led to a "flood of cheap credit" and a decrease in the care and monitoring of loans.[39] While investors and banks contributed to the

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33. *Id.* at 78. *See* Frank Partnoy & David A. Skeel, Jr., *The Promise and Perils of Credit Derivatives*, 75 U. CIN. L. REV. 1019, 1022 (2007) (calling CDOs a "pool of debt contracts").

34. Brunnermeier, *supra* note 30, at 78. *See* Partnoy & Skeel, *supra* note 33, at 1022. *See also Tranches*, INVESTOPEDIA, http://www.investopedia.com/terms/t/tranches.asp (last visited Nov. 11, 2011). Tranches are "[a] piece, portion or slice of a deal or structured financing. . . . [The] portion is one of several related securities that are offered at the same time but have different risks, rewards and/or maturities." *Id.*

35. Brunnermeier, *supra* note 30, at 78-79 (explaining that the top tranches generally receive AAA ratings, the highest credit rating for such investments, and the more senior of these tranches are sold to investors); Partnoy & Skeel, *supra* note 33, at 1022 ("Credit rating agencies rate the various tranches . . . whose terms vary depending on seniority.").

36. Brunnermeier, *supra* note 30, at 80 (providing the example that "certain money market and pension funds that were allowed to invest only in AAA-rated fixed-income securities could now also invest in a AAA-rated senior tranche of a portfolio constructed from BBB-rated securities").

37. *Laws, Sausages, and Bailouts*, *supra* note 15, at 178 (explaining that approximately half of the mortgages were bundled and sold to GSEs). *See, e.g.*, *Who Is Fannie Mae Today?*, FANNIEMAE, http://www.fanniemae.com/kb/index?page=home&c=aboutus (last visited Nov. 11, 2011); *Frequently Asked Questions About Freddie Mac*, FREDDIE MAC, http://www.freddiemac.com/corporate/company_profile/faqs (last visited Nov. 11, 2011).

38. David Reiss, *The Federal Government's Implied Guarantee of Fannie Mae and Freddie Mac's Obligations: Uncle Sam Will Pick Up the Tab*, 42 GA. L. REV. 1019, 1042-43 (2008) (arguing that while the statutory language was clear that securities issued by Fannie and Freddie were not backed by the federal government, Wall Street believed that the government would not permit Fannie and Freddie to fail).

39. Brunnermeier, *supra* note 30, at 82 ("Mortgage brokers offered teaser rates, no-documentation mortgages, piggyback mortgages . . . and NINJA ('no income, no job or assets') loans."). *See also* Timothy E. Lynch, *Deeply and Persistently Conflicted: Credit Rating Agencies in the Current Regulatory Environment*, 59 CASE W. RES. L. REV. 227, 232-33 (2009) (explaining that the complex nature of structured products "resulted in a situation where many security holders [did] not know the exact nature of the risks" borne by their investments).

economic crisis, there has been little commentary regarding the government's role in the economic decline.[40]

On the contrary, the criticism of credit rating agencies and their role in the economic crisis is more prevalent.[41] Specifically, credit rating agencies were accused of inflating credit ratings on mortgage-backed securities and then advising Wall Street firms about how to package the securities in order to obtain higher credit ratings from the credit rating agencies.[42] The credit rating agencies were paid by investment banks for both consulting services and for issuing credit ratings, creating at the very least an impression that such conduct was a conflict of interest.[43] Credit rating agencies have publicly denied such conflicts exist.[44]

B. *The Federal Government's Response to the Economic Crisis*

The blame for the economic crisis has been placed on the broad shoulders of the federal legislature and judiciary, the Department of Housing and Urban Development, the S.E.C., and of course, Wall Street firms gone wild.[45] Regardless of where the blame may lie, the federal government began to respond to the economic crisis in the fall of 2007,

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40. *See Laws, Sausages, and Bailouts*, *supra* note 15, at 175, 179 (stating that "a pointed study of the full range of *government* causes (and their attendant depth) has to date proven less attractive to authors and critics" and describing the Federal Reserve's role in triggering the growth of structured products by lowering the interest rate, prompting banks to make loans with less stringency). *But see* FIN. CRISIS INQUIRY COMM'N, *supra* note 16, at xxi (concluding that the government may have had a larger role in the crisis than originally thought and finding that the "government was ill prepared for the crisis, and its inconsistent response added to the uncertainty and panic in the financial markets").

41. Coffee, *supra* note 17, at 2, 12; *see* Lynch, *supra* note 39, at 234, 242 (addressing the relationship between the credit rating agencies, banks, and investors and arguing that inaccurate credit ratings fueled the housing market frenzy and created the conditions for the economic crisis).

42. Stephen Labaton, *Debt-Rating Agencies Are Under Scrutiny by S.E.C.*, N.Y. TIMES, Sept. 27, 2007, at C4. Then-Chairman of the S.E.C., Christopher Cox, stated that the Commission was examining whether credit rating agencies violated conflict of interest standards by rating various mortgage-backed securities and then providing investment firms advice on how to bundle the investments in order to garner higher credit ratings. *Id.*

43. *See id.*

44. *Id.* S & P's executive vice president, Vickie A. Tillman, was quoted as saying that while "'[s]ome have questioned whether the "issuer pays" model has led S.&P. and others to issue higher, or less rigorously analyzed, ratings so as to garner more business. There is no evidence—none at all—to support this contention with respect to S.&P.'" *Id.* Head of the asset-backed finance rating group at Moody's, Michael Kanef, was quoted as saying that "'[t]he integrity and objectivity of our rating processes is of utmost importance to us . . . . Our continued reputation for objective and independent ratings is essential to our role in the marketplace.'" *Id.*

45. Ledbetter, *supra* note 15, at 39 (arguing that Wall Street underwriters played a significant role in growing the subprime market and "abusing borrowers and investors"). *See generally Laws, Sausages, and Bailouts*, *supra* note 15, at 177 (suggesting and listing the various public sector actors that contributed to the economic crisis).

albeit in a more laissez-faire fashion under the Bush administration.[46] In an effort to increase the federal government's response, the Democrat-controlled Congress introduced various legislation related to mortgage reform.[47] In October 2008, Congress passed, and President George W. Bush signed, the Emergency Economic Stabilization Act[48] that has been dubbed the financial "bailout" plan.[49] The law authorized the U.S. Secretary of the Treasury to purchase up to $700 billion in distressed assets through TARP.[50] Mortgage-backed securities and CDOs were eligible for purchase by the Treasury.[51] TARP was initially intended to "clean up the balance sheets of the largest [financial] institutions," but instead, Treasury Secretary Henry Paulson directed the Treasury to "start injecting capital" into financial institutions by purchasing preferred stock.[52] The Federal Reserve played a critical role as well by providing liquidity to investment banks, and by rescuing Bear Stearns and American International Group.[53]

The congressional response to the economic crisis continued under the Obama administration and in July 2010, the Dodd-Frank Act was signed into law.[54] While the Dodd-Frank Act was reactionary in the sense that the law was implemented in *response* to the economic crisis, among the Act's stated goals are "to protect the American taxpayer" and

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46. *See* Joshua Wirth, Note, *Federal Regulation and Legislation in the Wake of the Subprime Mortgage Meltdown: A Legal Philosophical Analysis of Federal Government Responses to Market Bubbles*, 14 FORDHAM J. CORP. & FIN. L. 179, 186-87 (2008) (chronicling the Bush administration's position that the market would correct itself, however, the administration publicly encouraged: (1) changes to the Federal Housing Administration, (2) reform of the federal tax code to protect those mortgagers whose debt was forgiven, (3) a "foreclosure avoidance initiative," and (4) transparency and reliability in the mortgage market (internal quotation marks omitted)).

47. *See id.* at 191-93, 196-97 (describing in detail the various legislation introduced by Congressmen Christopher Dodd, Barney Frank, Bradley Miller, and Harry Reid).

48. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765.

49. *See* Robert Hockett, *A Fixer-Upper for Finance*, 87 WASH. U. L. REV. 1213, 1218 (2010) (internal quotation marks omitted) ("Congress and the White House first agreed on a stopgap financial 'bailout' plan early in October 2008.").

50. Emergency Economic Stabilization Act § 101(a)(1), 122 Stat. at 3767 (authorizing the establishment of TARP to purchase troubled assets from financial institutions); Hockett, *supra* note 49, at 1218 (explaining that TARP's "sheer size" of over $700 billion was "unprecedented").

51. David Goldman, *CNNMoney.com's Bailout Tracker*, CNNMONEY.COM, http://money.cnn.com/news/storysupplement/economy/bailouttracker/ (last visited Nov. 11, 2011) (detailing the various funds committed and invested by the federal government during the economic crisis, including funds to repurchase CDOs from American International Group).

52. David Gaffen, *The Evolution of TARP in the Struggle for Life*, WALL ST. J. (Feb. 9, 2009, 11:46 AM ET), http://blogs.wsj.com/marketbeat/2009/02/09/the-evolution-of-tarp-in-the-struggle-for-life/ (describing the "various iterations of the TARP").

53. Randall D. Guynn, *The Global Financial Crisis and Proposed Regulatory Reform*, 2010 BYU L. REV. 421, 435.

54. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

"to protect consumers."[55] Only time will tell whether the Dodd-Frank Act will have an impact and whether Congress can achieve the legislation's stated purpose of consumer protection.[56]

C. The Dodd-Frank Act

The Dodd-Frank Act represents the most significant change to the regulation of the U.S. financial markets since the Great Depression.[57] The swiftness with which the Act was passed is remarkable. The Act was introduced by Representative Barney Frank on December 2, 2009, passed in the House of Representatives on December 11, 2009 and in the Senate on May 20, 2010, and signed by President Obama on July 21, 2010.[58] Some critics argue that the Dodd-Frank Act was not passed quickly enough after the emergence of the economic crisis.[59]

According to President Obama, the legislation was designed to achieve "clear rules and basic safeguards" for the markets.[60] The

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55. *Id.* pmbl., 124 Stat. at 1376. *See also The Monitor: Bank Regulation*, BANKING & FIN. SERVS. POL'Y REP., Aug. 2010, at 34, 34.

56. *Financial-Regulatory Reform: The SEC Moving Forward*, INVESTMENTNEWS (Oct. 10, 2010, 6:01 AM ET), http://www.investmentnews.com/article/20101010/REG/310109990 [hereinafter *Financial-Regulatory Reform*] (quoting S.E.C. Commissioner Luis A. Aguilar's remarks on September 21, 2010 in which he indicated that "[t]he impact of the legislation will not be known for some time"). The objectives of Congress as expressed in the Dodd-Frank Act will not come to fruition if Congress does not adequately fund the S.E.C. and other agencies, such as the Commodity Futures Trading Commission, essentially crippling these agencies from being able implement and enforce the rulemaking provisions of the Act. *See* Bruce Carton, *How Can Congress Kill Dodd-Frank? By Underfunding It*, SEC. DOCKET (Jan. 20, 2011, 7:44 AM), http://www.securitiesdocket.com/2011/01/20/how-can-congress-kill-dodd-frank-by-underfunding-it/ (explaining that the S.E.C.'s budget was kept at its 2010 level even though Chairman of the S.E.C. Mary Schapiro had requested a significant increase for fiscal year 2011 and a 2009 report issued by the Government Accountability Office confirmed that the S.E.C. lacked funds to properly bring enforcement actions). In addition to critics' concerns regarding the over-expansive nature of the reform, there have been calls to repeal the legislation in its entirety. *See* Carla Main, *Dodd-Frank Repeal, OCC Bank Probe, Daley Picked: Compliance*, BLOOMBERG (Jan. 7, 2011), http://www.bloomberg.com/news/2011-01-07/dodd-frank-repeal-occ-bank-probe-daley-picked-compliance.html (describing Republican Representative Michele Bachmann's introduction of a bill aimed to repeal the Dodd-Frank Act).

57. *See* DAVIS POLK, *supra* note 12, at i; K&L GATES, *supra* note 11.

58. *Bill Summary & Status 111th Congress (2009 - 2010) H.R.4173 Major Congressional Actions*, LIBRARY OF CONG., http://thomas.loc.gov/cgi-bin/bdquery/z?d111:HR04173:@@@R (last visited Nov. 11, 2011) (providing a summary of all major Congressional actions related to the Dodd-Frank Act).

59. *See* Christine Hurt, *Dodd-Frank Forum: Bernard Madoff as the Big Idea*, CONGLOMERATE (July 20, 2010), http://www.theconglomerate.org/2010/07/doddfrank-forum-bernard-madoff-as-the-theory.html. The author argues that the Sarbanes-Oxley Act was passed quickly after the "villains" were identified. *Id.* In the case of Sarbanes-Oxley Act, it was the collapse of Enron and WorldCom that stirred the federal government into action. *Id.* The Dodd-Frank Act, on the other hand, was passed almost two years after the beginning of the economic crisis. *Id.*

60. *The Monitor: Bank Regulation*, *supra* note 55, at 34 (quoting President Obama from the

legislation sets forth a regulatory framework that includes both rulemaking requirements, and study and reporting provisions.[61] Studies estimate that the Dodd-Frank Act contains between 240 and 315 rulemaking provisions.[62] The Act covers a broad array of subject matter, including systemic risk regulation, bank capital, derivatives, deposit insurance reform, and regulation of credit rating agencies.[63]

As stated by President Obama, the Act requires the financial system to adjust to the changes set forth in the Act and regulators are responsible for ensuring that implemented rules are followed.[64] Though some regulators have already begun the rulemaking process,[65] other regulators, such as the S.E.C., have been stalled by the very institutions they are empowered to regulate.[66] Additionally, the S.E.C.'s current budget may not provide the agency with sufficient funds to implement or enforce the rules required under the Act.[67] Some commentators have

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Dodd-Frank Act signing ceremony on July 21, 2010) (internal quotation marks omitted).

61. *See* DAVIS POLK, *supra* note 12, at i; K&L GATES, *supra* note 11.

62. *See* DAVIS POLK, *supra* note 12, at i (estimating 243 rulemaking provisions and 67 studies); K&L GATES, *supra* note 11 (estimating 315 rulemaking requirements and 145 studies and reports).

63. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 931–939H, 124 Stat. 1376, 1872-90 (2010) (sections regulating credit rating agencies); DAVIS POLK, *supra* note 12, at i ("[B]oth financial institutions and commercial companies must now begin to deal with the historic shift in U.S. banking, securities, derivatives, executive compensation, consumer protection and corporate governance that will grow out of the general framework established by the Act.").

64. *The Monitor: Bank Regulation*, *supra* note 55, at 34 ("[F]or the new rules to be effective, regulators will need to be vigilant. Adjustments may need to be made along the way as the financial system adapts to the changes . . . .").

65. *See* Patrick Blum, *Will New Finance Rules Hurt Energy Industry?*, N.Y. TIMES, Oct. 12, 2010, *available at* http://www.nytimes.com/2010/10/13/business/energy-environment/13iht-rentrade.html ("The [Commodity Futures Trading Commission] published its first set of detailed rules this month . . . .").

66. *See, e.g.*, Letter from Susan J. Thomas, Sec'y & Assoc. Gen. Counsel, Ford Motor Credit Co., to Katherine Hsu, Senior Special Counsel, U.S. Sec. & Exch. Comm'n (July 22, 2010), http://www.sec.gov/divisions/corpfin/cf-noaction/2010/ford072210-1120-incoming.pdf (requesting that the Commission not recommend an enforcement action against Ford Motor Credit Co. because, in response to the repeal of Rule 436(g), several credit rating agencies "have indicated that they are not willing to provide their consent to the inclusion of their names or ratings in registration statements or prospectuses until they have had time to assess the implications of such consent"). In response, the S.E.C. issued a "no-action letter" allowing issuers, such as Ford Motor Credit Co., to omit credit ratings from registration statements for a period of six months. *See* Response from Katherine Hsu, Senior Special Counsel, U.S. Sec. & Exch. Comm'n, Office of Chief Counsel, Div. of Corp. Fin., to Ford Motor Credit Co. (Nov. 23, 2010), http://www.sec.gov/divisions/corpfin/cf-noaction/2010/ford072210-1120.htm.

67. *See* Mark Schoeff, Jr., *SEC Budget Woes May Bolster Case for Creation of SRO*, INVESTMENTNEWS (Jan. 2, 2011, 6:01 AM ET), http://www.investmentnews.com/article/20110102/REG/301029976 (noting that the S.E.C.'s budget concerns about its ability to adequately enforce the securities laws existed prior to the passage of the Dodd-Frank Act, but in light of the Commission's new responsibilities, the agency may not be able to effectively implement and enforce provisions of

suggested that the broad nature of the legislation may impede regulators in the implementation of the Act.[68] As suggested by an S.E.C. Commissioner, the impact of the legislation depends on the decisions by regulators.[69]

Both the expansive nature of the Act and the swiftness with which it was passed raise concerns about whether Congress adequately considered the consequences of such a vast reform.[70] The Act leaves much of the implementation and enforcement to regulators, but also leaves the door wide-open for those regulations to be influenced by the various groups affected by the regulations.[71] In short, while the aim of the Dodd-Frank Act is consumer protection, those protections may not come to fruition in light of the obstacles the legislation itself imposes in implementation and logistics.[72] Additionally, failure by Congress to give more specific direction leaves open the possibility that regulators will not implement policies in line with the stated consumer protection objective of the Act.[73]

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the Act).

68. *See* J. Scott Colesanti, *SEC Chiefs Past and Present at Fordham*, BUS. L. PROF BLOG (Sept. 28, 2010), http://lawprofessors.typepad.com/business_law/2010/09/sec-chiefs-past-and-present-at-fordham.html ("While guarded in his suggestions, [former S.E.C. Chairman Harvey] Pitt was pointed in his critiques, noting that the far-reaching Dodd-Frank Act may have 'set up' the Commission for a fall.").

69. *Financial-Regulatory Reform*, *supra* note 56 (quoting S.E.C. Commissioner Luis A. Aguilar's remarks on September 21, 2010 in which he indicated that the "impact [of the Dodd-Frank Act] will depend significantly on decisions made by regulators").

70. *See, e.g.*, Binyamin Appelbaum, *On Finance Bill, Lobbying Shifts to Regulations*, N.Y. TIMES, June 27, 2010, at A1 ("[The Dodd-Frank Act] is basically a 2,000-page missive to federal agencies, instructing regulators to address subjects ranging from derivatives trading to document retention. But it is notably short on specifics, giving regulators significant power to determine its impact—and giving partisans on both sides a second chance to influence the outcome."). Additionally, legislation with a clear congressional intent but poor drafting may not produce anticipated consequences. *The "Rushed Debate," supra* note 27, at 160 (concluding that a provision of the [Private Securities Litigation Reform Act of 1995] has been "ignored or diluted, despite the Congress' [sic] clear intent").

71. *See* Appelbaum, *supra* note 70, at A1 (stating that by giving regulators the power to implement regulations of the Act, "partisans on both sides [have] a second chance to influence the outcome").

72. *See* Carton, *supra* note 56. Although prior to the passage of the Dodd-Frank Act the S.E.C. asked for an increase of $182 million for fiscal year 2011—in an effort to add more full-time positions and to advance its technology in enforcement, risk-assessment, and market oversight—the S.E.C.'s 2011 budget was not increased from its 2010 level. *Id.* The passage of the Dodd-Frank Act has left the S.E.C. to create more offices, conduct and publish more than sixty-five studies, and promulgate more than 240 rules within a budget that the S.E.C. deemed inadequate in 2009. *See id.*

73. *See* Appelbaum, *supra* note 70, at A1 ("The much-debated prohibition on banks investing their own money, for example, leaves it up to regulators to set the exact boundaries. Lobbyists for Goldman Sachs, Citigroup and other large banks already are pressing to exclude some kinds of lucrative trading from that definition.").

D. Current Attempts to Repeal the Dodd-Frank Act

Some members of Congress have discussed repealing portions of the Dodd-Frank Act and the Senate has voted to repeal at least one provision of the Act.[74] After the Republican takeover of the House of Representatives in the November 2010 election,[75] some Republican leaders indicated a desire to repeal the entire Act.[76] In January 2011, Representative Michele Bachmann introduced a bill in the House of Representatives that would repeal the Dodd-Frank Act.[77] While a repeal of the Act may be on the horizon, the financial industry is more optimistic that a "technical corrections bill" will be passed in order to effectuate the implementation of the Act, but that a total repeal is not imminent.[78] Even if the Dodd-Frank Act is repealed, the economic crisis has stirred discussions regarding the credit ratings industry, its impact on the financial markets, and an appropriate regulatory scheme.[79]

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74. Press Release, Senator Patrick Leahy, Comment of Senator Patrick Leahy on Senate Passage of Bill to Repeal SEC FOIA Exemptions (Sept. 21, 2010), http://leahy.senate.gov/press/press_releases/release/?id=502e5f2c-88ca-430a-8dd4-d1377cd15298 (explaining the Senate's adoption of S. 3717, legislation to repeal exemptions to the Freedom of Information Act for the S.E.C. that were included in the Dodd-Frank Act, and urging the House of Representatives to pass the legislation).

75. *See Republicans Win House Majority, Make Senate Gains in Wave Election*, FOXNEWS.COM (Nov. 2, 2010), http://www.foxnews.com/politics/2010/11/02/poll-closing-key-east-coast-races-balance-power-line/.

76. *See* Stefan J. Padfield, *Is a Repeal of Dodd-Frank Looming?*, BUS. L. PROF BLOG (Oct. 23, 2010), http://lawprofessors.typepad.com/business_law/2010/10/is-a-repeal-of-dodd-frank-looming.html (citing a President Obama radio address in which the President discussed the stated intentions of Republican leaders in the Senate to repeal the Dodd-Frank Act and noting that the Republican radio address of Senator John Thune "did nothing to dispel [the] notion . . . that Democrats spent their time passing more and more burdensome regulations, like their so-called Financial Reform bill that failed to address the main cause of our economic mess" (internal quotation marks omitted)).

77. To Repeal the Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 87, 112th Cong. (2011). While a repeal of the Dodd-Frank Act appears imminent, the proposed legislation is similar to the House of Representative's repeal of the Democrats' health care reform measures, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010, passed in March 2010. *See* David M. Herszenhorn & Robert Pear, *As Vowed, House Votes to Repeal Health Care Law*, N.Y. TIMES, Jan. 20, 2011, at A1. The Democrat-controlled Senate has indicated that it will not act on the health care repeal legislation. *Id.* ("Leaders of the Democratic-controlled Senate have said that they will not act on the repeal measure, effectively scuttling it."). The bill to repeal the Dodd-Frank Act may face a similar fate in the Senate.

78. *See* Ben White, *What Does GOP Takeover Mean for Dodd-Frank?*, POLITICO (Nov. 4, 2010, 5:13 AM), http://www.politico.com/morningmoney/1110/morningmoney268.html (quoting Ken Bentsen, head of Wall Street trade group SIFMA's D.C. office). Mr. Bentsen stated that "[t]here was always the likelihood that there would be some form of technical corrections bill. That's not unprecedented when it comes to mammoth pieces of legislation. There are some questions about whether some of the provisions can work as enacted." *Id.*

79. *See, e.g.*, Coffee, *supra* note 17, at 2. While there is consensus that credit rating agencies

III. REGULATION OF CREDIT RATING AGENCIES

The regulation of credit rating agencies is not a new phenomenon, but an understanding of the way credit rating agencies operate is instrumental to understanding how these agencies have been regulated by the federal government. Section A briefly outlines how credit rating agencies operate. Section B describes the role that credit rating agencies played in the economic crisis that rocked the United States. Section C describes previous attempts by the federal government to regulate credit rating agencies. Section D describes the Dodd-Frank Act provisions specifically targeting credit rating agencies. While Section D, and more importantly this Note, focuses on Section 939G of the Dodd-Frank Act and the corresponding liability created under Section 11 of the Securities Act, the discussion is incomplete without at least an overview of the general provisions of Section 933. Finally, Section E offers policy justifications for creating liability against credit rating agencies in light of the economic crisis.

A. *The Nuts and Bolts of Credit Rating Agencies*

Credit rating agencies are for-profit, private companies that assess the creditworthiness of issuers of debt as well as rate debt instruments.[80] While there are more than one hundred credit rating agencies worldwide,[81] in the United States, three agencies control the industry—, Moody's Investor Services, Inc. ("Moody's"), Standard & Poor's

played a role in the economic crisis, "reformers divide between (1) those who want to subject [credit rating agencies] to closer regulation to purge the rating process of conflicts of interest, and (2) those who believe that the answer is deregulation through downsizing the role of credit ratings." *Id.* at 18.

80. U.S. SEC. & EXCH. COMM'N, REPORT ON THE ROLE AND FUNCTION OF CREDIT RATING AGENCIES IN THE OPERATION OF THE SECURITIES MARKETS 5 (2003), *available at* http://www.sec.gov/news/studies/credratingreport0103.pdf [hereinafter ROLE AND FUNCTION OF CREDIT RATING AGENCIES]. For an in-depth discussion of credit rating agencies, see generally RATINGS, RATING AGENCIES AND THE GLOBAL FINANCIAL SYSTEM (Richard M. Levich et al. eds., 2002). Credit rating agencies are statutorily defined as:

> [A]ny person (A) engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee, but does not include a commercial credit reporting company; (B) employing either a quantitative or qualitative model, or both, to determine credit ratings; and (C) receiving fees from either issuers, investors, or other market participants, or a combination thereof.

Credit Rating Agency Reform Act of 2006, 15 U.S.C. § 78c(a)(61).

81. BASEL COMM. ON BANKING SUPERVISION, *Credit Ratings and Complementary Sources of Credit Quality Information* 14 (Bank of Int'l Settlements, Working Paper No. 3, 2000), *available at* http://www.bis.org/publ/bcbs_wp3.htm.

Ratings Services ("S & P"), and Fitch Ratings, Ltd. ("Fitch").[82] The securities issuers provide the credit rating agencies with information that is not publicly available so that the credit rating agencies can rate their securities.[83] The issuers of the debt pay rating agencies to rate the issuers' securities, and this process of payment by the issuers is known as the "issuer-pays" model.[84] Once the credit rating agencies have analyzed the information provided by the securities issuers, the credit rating agencies make their ratings publicly available.[85] Credit rating agencies not only rate the securities upon issuance but also monitor the investment and revise credit ratings as necessary.[86] Critics argue that the "issuer-pays" model creates conflicts of interest and played a significant role in the economic crisis.[87]

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82. Claire A. Hill, *Regulating the Rating Agencies*, 82 WASH. U. L. Q. 43, 43 (2004) ("The major rating agencies—Moody's Investor Services, Standard and Poor's, and Fitch—rate debt instruments and companies."). *See also* SUMMARY REPORT OF CREDIT RATING AGENCIES, *supra* note 17, at 1 (describing the S.E.C.'s examination of Moody's, S & P, and Fitch, to review their role in the economic crisis).

83. *See* ROLE AND FUNCTION OF CREDIT RATING AGENCIES, *supra* note 80, at 26. Credit rating agencies consider, among other things, various information regarding securities issuers such as: (1) the issuer's method of cash generation and its use of cash, (2) the nature and amount of the issuer's assets and liabilities, (3) the issuer's debt-to-equity ratios, (4) interest coverage ratios, (5) cash flow predictions, (6) business projections, (7) amount and nature of fixed charges, (8) advanced notification of major corporate events, (9) nature of the issuer's markets, (10) efficiency of operations, (11) quality of management, (12) contractual commitments, (13) competitors, and (14) the issuer's regulatory risks. *Id.* at 26 n.64.

84. Lynch, *supra* note 39, at 239 (internal quotation marks omitted) (explaining that credit rating agencies replaced the "subscriber-pays" revenue model with the "issuer-pays" revenue model beginning in the mid-1970s (internal quotation marks omitted)). Credit rating agencies also rate the creditworthiness of securities issuers that do not pay for their services. *Id.* at 240. Such services are called "unsolicited ratings" and are based upon publicly available information. *Id.* (internal quotation marks omitted).

85. *See* ROLE AND FUNCTION OF CREDIT RATING AGENCIES, *supra* note 80, at 21-22 (describing the method by which credit rating agencies collect and analyze information in order to determine a rating for a security).

86. *Id.* at 27. Generally, securities are rated using a letter-designated grade that represents the credit rating agency's opinion that the debt issued will be repaid. *See, e.g.*, *Standard & Poor's Ratings Definitions*, STANDARD & POOR'S (Apr. 27, 2011, 16:09:53 EST), http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245303711350. S & P's long-term issue credit ratings are based on a scale of AAA, AA, A, BBB, BB, B, CCC, CC, C, and D, with plus (+) and minus (-) within each of the ratings indicating relative standing within each category. *Id.* A security rated AAA is a security with the lowest default risk—"[t]he obligor's capacity to meet its financial commitment on the obligation is extremely strong"—and a rating of D represents a security with the highest default risk—"[a]n obligation . . . is in payment default." *Id.*

87. *See* Lynn Bai, *On Regulating Conflicts of Interest in the Credit Rating Industry*, 13 N.Y.U. J. LEGIS. & PUB. POL'Y 253, 263-64 (2010); Coffee, *supra* note 17, at 2, 30-31. Both articles reiterate the position that a model that allows issuers to pay credit rating agencies for ratings creates a strong incentive for credit rating agencies to issue higher ratings regardless of the accuracy of such ratings. Bai, *supra*, at 263-64; Coffee, *supra* note 17, at 2, 30-31.

B. The Role of Credit Rating Agencies in the Economic Crisis

Credit rating agencies played a central role in the subprime mortgage crisis because they rated subprime securities that entered the market, which in turn affected the credit ratings of the institutions that held the investments.[88] Credit rating agencies were able to have such a significant influence on the markets because credit ratings are the primary way that investors assess the default risks associated with securities and issuers.[89] Credit rating agencies played two key roles in the economic crisis. First, credit rating agencies advised issuers regarding the structure of CDOs, rated various tranches, and admitted they failed to properly assess the credit risks of CDOs.[90] Second, credit rating agencies failed to manage conflicts of interest between issuers and the credit rating agencies.[91] The credit rating agencies had the opportunity to play such a significant role in the economic crisis because of the S.E.C.'s reluctance to take as active a role in regulating credit rating agencies as it has in regulating other actors in the financial markets.[92]

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88. *See* Amanda Bahena, *What Role Did Credit Rating Agencies (CRAs) Play in the Financial Crisis?*, UNIV. OF IOWA CTR. FOR INT'L FIN. AND DEV., http://blogs.law.uiowa.edu/ebook/sites/default/files/CRAs.pdf (last visited Nov. 11, 2011). *See also* Larry P. Ellsworth & Keith V. Porapaiboon, *Credit Rating Agencies in the Spotlight: A New Casualty of the Mortgage Meltdown*, BUS. L. TODAY, Mar.-Apr. 2009, at 35, 35 (arguing that investors had a "misplaced belief in the value of residential mortgage-backed securities" and that credit rating agencies produced ratings for many of the securities that led to the inflated real estate market).

89. *See* ROLE AND FUNCTION OF CREDIT RATING AGENCIES, *supra* note 80, at 19 ("The [S.E.C.] recognized that, in recent years, the importance of credit ratings to investors and other market participants had increased significantly, impacting an issuer's access to and cost of capital, the structure of financial transactions, and the ability of fiduciaries and others to make particular investments."). Rating agencies reduce costs and improve efficiency by allowing "less resource-rich investors" an opportunity to obtain information about issuers and securities that would otherwise be unavailable or inaccessible. *See* Lynch, *supra* note 39, at 241.

90. *See* Partnoy & Skeel, *supra* note 33, at 1022 ("Credit rating agencies rate the various tranches . . . whose terms vary depending on seniority."); Bahena, *supra* note 88 (explaining that credit rating agencies: (1) advised issuers how to structure CDOs to maximize profits and failed to adequately assess the credit risks in CDOs, and (2) failed to manage conflicts of interest in the rating process).

91. Bahena, *supra* note 88 (describing that the conflicts of interest were caused by: (1) relationship conflicts, (2) issuer-paid ratings, and (3) advising issuers on how to structure CDOs to get the highest ratings).

92. *See Laws, Sausages, and Bailouts*, *supra* note 15, at 212 ("[The Commission], uneasy with a supervisory role it inherited by default, simply shunned final action [on credit agency regulation] until it was ordered by Congress" via the passage of the Credit Rating Agency Reform Act of 2006.). In fact, not until September 2007 were Moody's, S & P, and Fitch subject to the S.E.C.'s regulations for credit rating agencies. SUMMARY REPORT OF CREDIT RATING AGENCIES, *supra* note 17, at 1. Prior to 2007, and generally from 1975 to 2006, Moody's and S & P (and more recently Fitch) were subject to the S.E.C.'s regulations through a requirement that institutional investors and broker-dealers who wished to hold debt securities in their portfolios obtain ratings for

C. *Previous Attempts to Regulate Credit Rating Agencies*

While credit rating agencies have played a significant role in the financial industry in the past decade,[93] prior to the enactment of the Credit Rating Agency Reform Act of 2006 (the "Rating Agency Reform Act"),[94] the agencies were largely unregulated.[95] The 2006 regulation was a response to the collapse of several large and well-rated companies, namely Enron and WorldCom, and its purpose is to regulate the credit rating industry in order to prevent similar incidents.[96] The Rating Agency Reform Act amended the Securities Exchange Act of 1934 (the "Exchange Act") to include Section 15E.[97] Section 15E provides for the registration of NRSROs upon submission of various documents and information to the S.E.C.[98]

While the Rating Agency Reform Act gave the S.E.C. power to restrict conflicts of interest, even requiring information and documentation from the credit rating agencies regarding the existence of such conflicts, the legislation specifically prohibited the S.E.C. from

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such debt. Coffee, *supra* note 17, at 19. The institutional investors and broker-dealers could only rely on ratings from NRSROs for these regulatory purposes. *Id.* Further, the S.E.C. did not formally establish criteria to determine which credit rating agencies were deemed to be NRSROs. *Id.* During the period from 1975 to 2006, the S.E.C. refused almost all applications from credit rating agencies to be registered as NRSROs. *Id.*

93. *See* ROLE AND FUNCTION OF CREDIT RATING AGENCIES, *supra* note 80, at 19.

94. Credit Rating Agency Reform Act of 2006, Pub. L. No. 109-291, 120 Stat. 1327 (codified as amended at 15 U.S.C. § 78o-7).

95. *Laws, Sausages, and Bailouts*, *supra* note 15, at 212 (stating that from 2003 to 2006, "the SEC did nothing tangible in response to the comments" the Commission received when it requested public comment regarding credit agency rules).

96. Lynch, *supra* note 39, at 267-68. *See* Credit Rating Agency Reform Act of 2006 pmbl., 120 Stat. at 1327 (stating that the purpose of the act is "[t]o improve ratings quality for the protection of investors"). While both Moody's and S & P downgraded their ratings of Enron, Enron's ratings remained above investment-grade days before the company went bankrupt. *See* Amy Borrus et al., *The Credit-Raters: How They Work and How They Might Work Better*, BUSINESSWEEK, Apr. 8, 2002, at 38, 38. As a result, critics argued that the credit rating agencies did not do enough to obtain accurate information from Enron in order to make an informed decision regarding the company's credit rating. *Id.* at 40. S & P countered that its ratings were coupled with public warnings that Enron's rating would be lowered to junk status if a proposed merger was not completed. *Id.* Enron remained at investment grade until just four days before it declared bankruptcy. *Id.* at 38.

97. Credit Rating Agency Reform Act § 4(a), 120 Stat. at 1329. *See also* SUMMARY REPORT OF CREDIT RATING AGENCIES, *supra* note 17, at 4 ("The Act created a new Section 15E of the Securities Exchange Act of 1934 . . . .").

98. Credit Rating Agency Reform Act of 2006, 15 U.S.C. § 78o-7(a)(1)(A)–(B) (listing the various requirements that must be met by a credit rating agency electing to be treated as an NRSRO, including submission of various information to the S.E.C., but not limited to performance measurement statistics, procedures and methodologies in determining credit rating agencies, policies and procedures adopted to prevent misuse of material, nonpublic information, and conflicts of interest relating to the issuance of credit ratings).

regulating the substance of credit ratings or the policies and procedures by which credit rating agencies determined credit ratings.[99] Under the Dodd-Frank Act, the S.E.C. continues to have the responsibility of requiring disclosure and monitoring compliance with its registration requirements.[100] While the Act does not give the S.E.C. the power to regulate the substance of credit ratings, the Dodd-Frank Act does provide the S.E.C. with additional enforcement mechanisms.[101]

D. *Provisions in the Dodd-Frank Act Related to the Regulation of Credit Rating Agencies*

In light of criticisms that credit rating agencies failed to accurately reflect the risks inherent in complicated structured products such as CDOs and contributed significantly to the decline in the financial markets, provisions in the Dodd-Frank Act specifically target those aspects of the credit rating business that, at least in part, contributed to the economic crisis.[102] While there may be a consensus that credit rating agencies played a role in the economic crisis,[103] there is less consensus

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99. *Id.* § 78o-7(c)(2).

100. *See Credit Rating Agencies*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/spotlight/dodd-frank/creditratingagencies.shtml (last modified Aug. 19, 2011) [hereinafter *Credit Rating Agencies*] ("The Dodd-Frank Wall Street Reform and Consumer Protection Act enhances the SEC's enforcement mechanisms . . . .").

101. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec 932(a)(8), § 15E(r), 124 Stat. 1376, 1879 (2010); *Credit Rating Agencies*, *supra* note 100 (explaining that the Dodd-Frank Act requires the S.E.C. to adopt, among others, several rules concerning application and disclosure of credit rating methodologies, form disclosure of data and assumptions underlying credit ratings, and consistent application of rating symbols and definitions).

102. Dodd-Frank Wall Street Reform and Consumer Protection Act § 931(5), 124 Stat. at 1872 (explaining that the ratings of structured financial products by credit rating agencies during the economic crisis were inaccurate and that the "inaccuracy contributed significantly to the mismanagement of risks by financial institutions and investors, which in turn adversely impacted the health of the economy in the United States and around the world"). *See also* DAVIS POLK, *supra* note 12, at 75 ("[C]ritics and regulators have attributed such rating failures to a lack of internal controls, conflicts-of-interest inherent in the issuer-pay business model, a lack of transparency and a perceived absence of accountability for credit rating agencies. . . . [V]arious commentators have asserted that the use of credit ratings in U.S. statutes and regulations has contributed to an over-reliance on credit ratings and an incorrect assumption that such credit ratings bear an implicit government seal-of-approval.").

103. The Dodd-Frank Act states:

> Because of the systemic importance of credit ratings and the reliance placed on credit ratings by individual and institutional investors and financial regulators, the activities and performances of credit rating agencies, including nationally recognized statistical rating organizations, are matters of national public interest, as credit rating agencies are central to capital formation, investor confidence, and the efficient performance of the United States economy.

Dodd-Frank Wall Street Reform and Consumer Protection Act § 931(1), 124 Stat. at 1872. *See also* Guynn, *supra* note 53, at 472 ("Among the many weaknesses identified as contributing to the as to the reforms that would prevent such future failures.[104] The Dodd-Frank Act, among other things, requires greater transparency of rating procedures and methodologies, provides the S.E.C. with greater enforcement mechanisms, subjects NRSROs to expert liability, and provides investors with a private cause of action against credit rating agencies.[105]

Sections 931 to 939H of the Dodd-Frank Act relate to the regulation of credit rating agencies.[106] The credit rating agency provisions in the Act create a regulatory framework that appears to provide the S.E.C. with increased enforcement power and also subjects the credit rating agencies to increased liability for their credit ratings.[107]

1. Section 933

Section 933 of the Dodd-Frank Act creates a private cause of action against credit rating agencies by placing statements made by the credit rating agencies on the same level as "statements made by a registered public accounting firm or a securities analyst under the securities laws."[108] Previously, such statements by credit rating agencies had been deemed "forward-looking statements" and were exempt from liability under the safe harbor provision of Section 21E of the Exchange Act.[109] Additionally, Section 933 establishes recklessness as the requisite state

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financial crisis was the conduct of credit rating agencies, which were blamed for not adequately or accurately identifying credit risk in their securities ratings."); Coffee, *supra* note 17, at 2.

104. *See* Coffee, *supra* note 17, at 2-3. There appear to be fundamental disagreements regarding the role credit rating agencies should play in the financial markets. *Id.* at 2-3. Such fundamental disagreements are the basis for the variety of reforms. *Id.* at 3.

105. Dodd-Frank Wall Street Reform and Consumer Protection Act sec. 932(a)(8), § 15E(p)(1)(A), 124 Stat. at 1877 (establishing the Office of Credit Ratings within the S.E.C. to administer rules related to credit rating agencies); DAVIS POLK, *supra* note 12, at 75 (describing credit rating agency regulations and noting that the credit rating provisions will "raise costs and litigation exposure" for credit rating agencies).

106. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act §§ 931–939H, 124 Stat. at 1872-90.

107. *See* DAVIS POLK, *supra* note 12, at 75.

108. Dodd-Frank Wall Street Reform and Consumer Protection Act sec. 933(a), § 15E(m)(1), 124 Stat. at 1883. *See also Dodd-Frank Issue Brief: Requirements Affecting Credit Rating Agencies*, COUNCIL OF INSTITUTIONAL INVESTORS, 2 (Apr. 2011), http://cii.org/UserFiles/file/resource%20 center/publications/Dodd-Frank%20-%20Requirements%20Affecting%20CRAs.pdf.

109. COUNCIL OF INSTITUTIONAL INVESTORS, *supra* note 108, at 3; Edward A. Fallone, *Section 10(b) and the Vagaries of Federal Common Law: The Merits of Codifying the Private Cause of Action Under a Structuralist Approach*, 1997 U. ILL. L. REV. 71, 86 (explaining that the "statutory safe harbor" provision for the disclosure of forward-looking statements could not give rise to liability if: (1) they were made without actual knowledge that they were false or misleading, or (2) they were accompanied by cautionary statements explaining factors that could keep the forward-looking statements from being accurate).

of mind for private causes of action against credit rating agencies.[110] As discussed *infra*, although the statutory provisions creating a cause of action against credit rating agencies are likely to meet resistance in the courts,[111] such provisions at the very least enhance the credit rating agencies' exposure to liability.[112]

2. Section 939G

The Dodd-Frank Act specifically creates a path for private litigants to pursue causes of action against credit rating agencies. Specifically, Section 939G of the Act repeals Rule 436(g),[113] which provided an exemption for credit ratings assigned by NRSROs from being included as part of the registration statement prepared by or certified by a person under Sections 7 or 11 of the Securities Act.[114] Under the provisions in Rule 436(g), NRSROs must consent to the inclusion of their credit ratings on issuer registration statements.[115] NRSROs that consent to the inclusion of their credit ratings on registration statements will be subject to liability for misrepresentations or omissions under Section 11 of the Securities Act.[116] Liability under Section 11 establishes a private right of action against credit rating agencies for statements made on registration statements to the same extent that registered public accountants and

110. As stated in the Dodd-Frank Act:

> In the case of an action for money damages brought against a credit rating agency . . . it shall be sufficient, for purposes of pleading any required state of mind in relation to such action, that the complaint state with particularity facts giving rise to a strong inference that the credit rating agency knowingly or recklessly failed [to conduct an investigation or obtain reasonable verification of facts].

Dodd-Frank Wall Street Reform and Consumer Protection Act sec. 933(b)(2), § 21D(b)(2)(B), 124 Stat. at 1883-84.

111. *See infra* Part VI.B.2.

112. Steven Ramirez, *Dodd-Frank VI: Punting on Credit Ratings*, CORP. JUST. BLOG (July 27, 2010, 6:46 PM), http://corporatejusticeblog.blogspot.com/2010/07/dodd-frank-vi-punting-on-credit-ratings.html.

113. Dodd-Frank Wall Street Reform and Consumer Protection Act § 939G, 124 Stat. at 1890.

114. 17 C.F.R. § 230.436(g)(1) (2011), *repealed by* Dodd-Frank Wall Street Reform and Consumer Protection Act § 939G, 124 Stat. at 1890 (exempting from registration statements "the security rating assigned to a class of debt securities, a class of convertible debt securities, or a class of preferred stock by a nationally recognized statistical rating organization"). Section 7 of the Exchange Act requires registration statements to include the names of individuals that have consented to preparing or certifying: (1) any part of the registration statement or (2) valuation in connection with the registration statement. Securities Act of 1933, 15 U.S.C. § 77g(a) (2006).

115. DAVIS POLK, *supra* note 12, at 76 (explaining that an issuer that wishes to include a credit rating by an NRSRO on its registration statement must obtain the consent of the NRSRO). *See* 17 C.F.R. § 230.436(b) ("[I]nformation [that] is set forth in the registration statement upon the authority of or in reliance upon such persons as experts, the written consents of such persons shall be filed as exhibits to the registration statement.").

116. DAVIS POLK, *supra* note 12, at 76.

securities analysts are subject to liability.[117] As discussed *infra*, credit rating agencies have not taken kindly to the requirement that they be named as experts on registration statements and in fact have refused to provide their consent to issuers.[118]

E. Policy Justifications for Assessing Liability Against Credit Rating Agencies

Many critics have expressed animosity toward credit rating agencies and have pitted them as key players in the economic crisis.[119] While most investors and financial institutions sustained losses, credit rating agencies profited during the economic crisis.[120] The Dodd-Frank Act acknowledges the importance of credit rating agencies and the reliance that investors, the markets, and regulators placed on credit ratings during the economic crisis.[121] Additionally, the Act reflects the sentiment that credit rating agencies are "gatekeepers" in the debt market and should be subject to oversight and accountability much like the standards of liability that apply to auditors, securities analysts, and investment bankers.[122] These justifications are the basis for creating a private right of action against credit rating agencies.

IV. SECURITIES LITIGATION AND PRIVATE CAUSES OF ACTION

In order to understand how Section 939G created a private cause of action against credit rating agencies, an examination of securities litigation and private causes of action is essential. Section A provides an overview of private securities fraud actions as created by the federal securities laws. Section A explains the difference between causes of action under Section 10(b) of the Exchange Act ("Section 10(b)")[123] and Sections 11 and 12 of the Securities Act. One major distinction between

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117. Dodd-Frank Wall Street Reform and Consumer Protection Act sec. 933(a), § 15E(m), 124 Stat. at 1883 (amending Section 15E(m) of the Exchange Act to establish that the "enforcement and penalty provisions of this title shall apply to statements made by a credit rating agency in the same manner and to the same extent as . . . a registered public accounting firm or a securities analyst").

118. *See infra* Part VI.C.

119. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act § 931(5), 124 Stat. at 1872; Coffee, *supra* note 17, at 2; Ramirez, *supra* note 112 ("The credit rating agencies played a central role in the entire subprime debacle . . . .").

120. Ramirez, *supra* note 112 (illustrating that the credit rating agencies profited from the "very bubble they helped inflate"). Credit rating agencies charge companies that issue securities to rate investments. *See* Lynch, *supra* note 39, at 239-40 (explaining ways in which credit rating agencies earn profits).

121. Dodd-Frank Wall Street Reform and Consumer Protection Act § 931(1), 124 Stat. at 1872.

122. *Id.* § 931(2)–(3), 124 Stat. at 1872 (internal quotation marks omitted).

123. Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (2006).

the causes of action under these laws is the requirement under Section 10(b) that a plaintiff prove loss causation. While plaintiffs are not required to prove loss causation in Section 11 and 12 cases, as Section B explains, the impact of the loss causation defense is sometimes asserted by defendants in such cases.

A. *Private Securities Fraud Actions Under the Federal Securities Laws*

Private federal securities fraud actions are based upon federal securities statutes and rules promulgated thereunder.[124] Courts have held that investors seeking to hold those who participate in the sale of securities—i.e., issuers, underwriters, broker-dealers, and the like—have an *implied* private cause of action under various provisions of the securities laws.[125] Section 10(b) is considered the "catch-all"[126] antifraud provision and is the broadest prohibition of fraudulent activities under the federal securities laws.[127] Congress has imposed statutory requirements on private causes of action.[128]

In addition to implied causes of action, other provisions of the federal securities laws provide an *express* cause of action. Sections 11 and 12 of the Securities Act specifically create liability against issuers and other enumerated parties for making untrue statements of material

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124. *See, e.g.*, *id.* ("It shall be unlawful . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device . . . in contravention of such rules and regulations as the Commission may prescribe as necessary . . . ."). *See also* Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5(b) (2011) ("It shall be unlawful . . . [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading . . . .").

125. *See* Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 157 (2008) ("Though the text of the Securities Exchange Act does not provide for a private cause of action for § 10(b) violations, the Court has found a right of action implied in the words of the statute and its implementing regulation." (citing Superintendent of Ins. of N.Y. v. Bankers Life & Casualty Co., 404 U.S. 6, 13 n.9 (1971))).

126. Thomas Corcoran, one of the drafters of Section 10(b), referred to the provision as a "catch-all." *Stock Exchange Regulation: Hearing on H.R. 7852 and H.R. 8720 Before the H. Comm. on Interstate and Foreign Commerce,* 73d Cong. 115 (1934) (statement of Thomas Gardiner Corcoran, Counsel, Reconstruction Finance Corporation). *See also* Herman & MacLean v. Huddleston, 459 U.S. 375, 382 (1983) ("§ 10(b) is a catchall antifraud provision . . . ." (internal quotation marks omitted) (citing Chiarella v. United States, 445 U.S. 222, 234-35 (1980))).

127. *See* Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385, 392, 463 (1990) ("[Rule 10b-5] is as broad as almost any statute, a sort of long-arm provision in which the SEC forbids everything the statute gives it power to forbid. . . . [T]he rule has been given extraordinary prominence, almost eclipsing everything else as a source of federal securities law at least in the courts." (footnotes omitted)).

128. *See, e.g.*, Private Securities Litigation Reform Act, 15 U.S.C. § 78u-4(a) (2006) (outlining the requirements for private class actions in violation of the Exchange Act). *See also* Fallone, *supra* note 109, at 81-86 (describing the procedural elements of the Private Securities Litigation Reform Act).

fact or omissions in registration statements and prospectuses and communications.[129] Under Section 11 of the Securities Act, non-issuers that can be held liable for misstatements include accountants, underwriters, and individuals who consent to having prepared or certified any part of the registration statement or certified any report or valuation used in connection with the registration statement.[130] Plaintiffs can maintain a cause of action under Section 10(b) for fraudulent misrepresentation even if the conduct is also actionable under Section 11.[131]

The significant difference for plaintiffs under the various provisions is the burden to establish each cause of action. Section 11 places a minimal burden on the plaintiff whereas Section 10(b) carries a heavier burden.[132] The distinction between the causes of action under Section 10(b) and Section 11 lies in the elements plaintiffs are required to prove.[133] Plaintiffs seeking to recover under Section 10(b) and alleging a violation of S.E.C. Rule 10b-5 ("Rule 10b-5") must prove: (1) a material misrepresentation; (2) scienter; (3) a connection with the purchase or sale of a security; (4) transaction causation or reliance; (5) economic loss; and (6) loss causation.[134] A claim under Section 11 requires a plaintiff to prove: (1) he purchased a registered security either from an issuer or in an aftermarket following the offering; (2) the defendant is one of the enumerated parties under the provision, i.e., issuer, director, or individual providing consent for reviewing or reporting information in the registration statement; and (3) the registration statement contained an untrue statement of material fact or omission of material fact.[135]

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129. Securities Act of 1933, 15 U.S.C. § 77k(a) (2006) (establishing civil liability for misrepresenting or omitting a material fact in registration statements); *id.* § 77*l*(a) (establishing civil liability in connection with misrepresentations in prospectuses and communications).

130. *Id.* § 77k(a)(4)–(5). Under the Securities Act, companies are required to disclose information through registration of securities. *Registration Under the Securities Act of 1933*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/answers/regis33.htm (last modified Sept. 2, 2011). Registration statements are filed with the S.E.C. and provide information regarding a company's assets, a description of the security for sale, information regarding management, and financial statements certified by accountants. *Id.* The registration statements are made available to the public after the S.E.C. has reviewed the documents to determine that the company has complied with the registration requirements, however, the S.E.C. does not evaluate the "merits of offerings." *Id.*

131. *See* Herman & MacLean v. Huddleston, 459 U.S. 375, 387 (1983) (holding that "the availability of an express remedy under § 11 of the [Securities] Act does not preclude defrauded purchasers of registered securities from maintaining an action under § 10(b) of the [Exchange] Act").

132. *Id.* at 382.

133. *See id.*

134. Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 341-42 (2005) (describing in detail each of the elements of a cause of action under Section 10(b)).

135. 15 U.S.C. § 77k(a).

Consequently, plaintiffs bringing a cause of action under Section 11 are not required to allege scienter, reliance, or loss causation.[136] In Section 11 actions, defendants may raise a due diligence defense[137] or the absence of loss causation as a mitigation defense[138] against a plaintiff's claims. The loss causation defense may prove problematic for plaintiffs seeking to bring claims against credit rating agencies under Section 11.[139]

B. *Impact of Loss Causation in Section 11 Liability Cases*

Plaintiffs seeking to recover losses under Section 10(b) are required to prove loss causation, in contrast to plaintiffs seeking to recover under Section 11.[140] To avoid liability under Section 11, defendants can assert the absence of loss causation as an affirmative defense.[141] Loss causation

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136. *See* Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179, 2183 (2011) (holding that securities fraud plaintiffs need not plead loss causation to obtain class certification); *In re* Morgan Stanley Info. Fund Sec. Litig., 592 F.3d 347, 359 (2d Cir. 2010) (citing Rombach v. Chang, 355 F.3d 164, 169 n.4 (2d Cir. 2004)).

137. The due diligence defense is statutorily available to non-issuer defendants. *See* 15 U.S.C. § 77k(b)(3)(B)(i) ("[N]o person, other than the issuer, shall be liable . . . as regards [to] any part of the registration statement purporting to be made upon his authority as an expert [under Section 7 of the Exchange Act if] . . . he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated . . . ."). *See Huddleston*, 459 U.S. at 382 ("Liability against the issuer of a security is virtually absolute, even for innocent misstatements. Other defendants bear the burden of demonstrating due diligence."(footnote omitted)); *In re Morgan Stanley*, 592 F.3d at 359 n.7 ("[S]ection 11 provides several due diligence defenses available to non-issuer defendants . . . .").

138. Defendants may avoid liability for damages based on depreciation in value of the security that is caused by an event other than the misrepresentations or omissions in the registration statement. *See* 15 U.S.C. § 77k(e). *See also* Iowa Pub. Emps.' Ret. Sys. v. MF Global, Ltd., 620 F.3d 137, 145 (2d Cir. 2010) ("[A]bsence of loss causation is an affirmative defense. . . . A causation defense prevails if the defendant 'proves' that an otherwise recoverable loss was not caused by the alleged misstatement or omission.").

139. *See infra* Part VI.B.2.

140. *See supra* Part IV.A.

141. *See supra* note 138 and accompanying text. The court in *Lentell v. Merrill Lynch & Co.* held:

> [I]f the loss was caused by an intervening event, like a general fall in the price of Internet stocks, the chain of causation . . . is a matter of proof at trial and not to be decided on a Rule 12(b)(6) motion to dismiss. However, when the plaintiff's loss coincides with a marketwide phenomenon causing comparable losses to other investors, the prospect that the plaintiff's loss was caused by the fraud decreases . . . .

396 F.3d 161, 174 (2d Cir. 2005) (citations omitted) (internal quotation marks omitted). *But see* King County v. IKB Deutsche Industriebank AG, 708 F. Supp. 2d 334, 343 (S.D.N.Y. 2010) (denying Moody's and S & P's motion to dismiss claims against them due to the absence of loss causation because "*Lentell* does not say that the existence of a market-wide phenomenon necessarily *eliminates* a plausible causal connection between plaintiffs' losses and defendants' alleged fraud"). The Court noted however that "[t]his is not to say that the financial crisis cannot break the chain of

is the causal connection between the material misrepresentation and the economic loss.[142] In considering loss causation, the U.S. Supreme Court has taken into consideration "intervening causes," other than the misrepresentation or omission, which may have caused the decline in value of the security.[143] A general market decline, as seen when the Internet bubble burst in 2000, was commonly used by defendants as an "intervening cause" to establish the absence of loss causation in "Global Settlement" litigations.[144]

V. THE "GLOBAL SETTLEMENT" INVOLVING INVESTMENT BANKERS AND RESEARCH ANALYSTS

Litigation against major players in the financial markets is not a new phenomenon. In fact, in the late 1990s and early 2000s, some of the largest Wall Street firms were the center of a major conflict of interest scandal involving investment bankers and research analysts. The resulting investigation and settlement by these firms became known as the "Global Settlement." Section A describes the conflict, investigation, and eventual settlement between the Wall Street firms and government actors known as the "Global Settlement." As a result of the information that was revealed regarding the conflicts of interest between investment bankers and research analysts at financial firms, private causes of action ensued. Section B explains the role that judicial interpretation of the loss causation requirement played in the unsuccess of such private causes of action against the Wall Street firms.

A. *The "Global Settlement"*

Conflict of interest concerns involving actors in the financial markets are anything but a new concept. During the 1990s, research analysts and investment bankers were "joined at the hip" and as a result, the research issued by the analysts was less than objective.[145] Research

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causation when considered in a different factual context." *Id.* at 343 n.64.

142. Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 342 (2005). Plaintiffs bear the burden of proving both proximate cause and economic loss. *Id.* at 346.

143. *See id.* at 342 (explaining that when a purchaser sells shares before the "relevant truth" is revealed, "the misrepresentation will not have lead to any loss"). Further, the Court held that even after the truth is disseminated to the marketplace, and the shares of the security sell at a lower price, "that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price." *Id.* at 342-43.

144. *See infra* Part V.B.

145. Barbara Moses, *They Were Shocked, Shocked: The "Discovery" of Analyst Conflicts on Wall Street*, 70 BROOK. L. REV. 89, 90 (2004).

analysts study companies that issue securities.[146] Based on the research, the analysts make recommendations regarding the purchase, sale, or retention of the securities issued by issuers.[147] Research analysts are either unaffiliated[148] or are considered "sell-side" analysts, employed by brokerage firms that are the underwriters for many of the securities the analysts are required to research.[149]

Both analysts and underwriters of securities benefit from analyst recommendations that encourage trading in the investments.[150] Providing investment banking services, such as underwriting an initial public offering, tends to be a large source of income for brokerage firms.[151] The structure of the research analyst and investment banker relationship created pressure on analysts to recommend stocks based on the needs of the brokerage firm's investment bankers—issuing "overwhelmingly positive" research reports that were not always in line with the interests of the retail investors.[152] Additionally, brokerage firms made little effort

146. *See FINRA Guide to Understanding Securities Analyst Recommendations*, FINRA, http://www.finra.org/Investors/SmartInvesting/AdvancedInvesting/UnderstandingSecuritiesAnalystRecommendations/index.htm (last visited Nov. 11, 2011) ("Research analysts study companies and draw on a wealth of industry, economic, and business trend information to help their clients make better investment decisions.").

147. Moses, *supra* note 145, at 92. Generally, analysts summarize research reports with a recommendation for whether an investor should "Buy," "Hold," or "Sell" a security. FINRA, *supra* note 146. While the terms used by firms vary, the recommendations include language suggesting that the investor should purchase, hold on to, or sell the security at issue. *Id.*

148. FINRA, *supra* note 146 (explaining that unaffiliated analysts "sell their independent research to financial or investing institutions, banks, insurance companies, or private investors on a project or subscription basis").

149. "Sell-side" analysts are those employed by full-service brokerage firms that provide research to retail clients for free or for a nominal fee. Moses, *supra* note 145, at 92 (internal quotation marks omitted). While the brokerage firms provide the research for free or for a nominal cost, the brokerage firms charge their retail clients for other activities such as investment banking. *Id.*

150. FINRA explains:

> [M]any analysts work for large financial firms that underwrite securities. An underwriter acts as an intermediary between the company publicly offering securities and investors buying the new stock. Even after the initial public offering, or IPO, it may have an ongoing relationship with the company or own a significant amount of the company's stock. And it will often stand to benefit from analyst recommendations that would tend to support the price of or encourage trading in that security.

FINRA, *supra* note 146.

151. Moses, *supra* note 145, at 93 (quoting then-acting Chairman of the S.E.C., Laura Unger, who explained that positive recommendations "can trigger higher trading volumes, resulting in greater commissions for the firms" (internal quotation marks omitted)). *See also* FINRA, *supra* note 146 (explaining the various conflicts of interest that analysts face when offering recommendations regarding securities).

152. Moses, *supra* note 145, at 90, 94. *See also* FINRA, *supra* note 146 ("[T]he analyst may feel an incentive not to say or write things that could jeopardize existing or potential client relationships for their investment banking colleagues."). *But see id.* ("On the other hand, the analyst may also be more knowledgeable or diligent in his research because his firm did the underwriting.").

to protect research analysts from investment banking pressure, so much so that analysts became part of investment banking teams, attempted to "woo issuers," and were paid based on the profitability of the firm's investment banking business.[153] The structure of the research analyst and investment banker relationship was apparent and yet, regulators and Congress expressed little to no concern until the Internet bubble burst in 2000.[154]

In March 2001, almost a year after the NASDAQ closed at an all-time high,[155] a Merrill Lynch & Co. ("Merrill Lynch") customer filed an arbitration claim against the brokerage firm and one of its research analysts, Henry Blodget.[156] Merrill Lynch ultimately settled the

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The investigation into the research analyst and investment banking conflict of interest revealed that some sell-side analysts were publicly recommending securities but privately selling the investments. Moses, *supra* note 145, at 94 ("[S]ell-side analysts privately derid[ed], [sold], or even short[ed] securities while recommending the same stock to the investing public.").

153. Moses, *supra* note 145, at 93-94 (referencing a 2001 S.E.C. survey that found most full-service brokerage firms participated in such practices).

154. *See id.* at 97 ("Despite the abundant evidence that something was seriously amiss in the world of equity analysts, there was little or no effort to fix it so long as the market continued to rise. No Congressional hearings were held; no significant rulemaking was initiated by the Commission or the self-regulatory organizations . . . ."). In June 2000, the NASDAQ Composite Index dropped by more than 1000 points from its record high closing in March 2000 and by July 2001 had lost another 2000 points. *See Statistical Milestones*, NASDAQ NEWSROOM, http://quotes.nasdaq.com/aspx/StatisticalMilestones.aspx (last visited Nov. 11, 2011) (reflecting that the NASDAQ Composite hit a high of 5046.86 on March 9, 2000); *June 2000 NASDAQ 100 Historical Prices/Charts*, TRADINGCHARTS.COM, http://tfc-charts.w2d.com/historical/ND/2000/6/linewchart.html (last visited Nov. 11, 2011) (reflecting that the NASDAQ hit 3800 in June 2000); *2001 NASDAQ 100 Historical Prices/Charts*, TRADINGCHARTS.COM, http://futures.tradingcharts.com/historical/ND/2001/0/continuous.html (last visited Nov. 11, 2011) (reflecting that the NASDAQ dropped to 1800 in July 2001). In April 2002, after a ten-month long investigation, N.Y. Attorney General Eliot Spitzer initiated a Martin Act proceeding against Merrill Lynch Research Analyst Henry Blodget and others. Moses, *supra* note 145, at 99-100. Also in April 2002, after Attorney General Spitzer announced his Martin Act proceeding, the S.E.C., National Association of Securities Dealers ("NASD"), and New York Stock Exchange ("NYSE") announced a joint investigation with Attorney General Spitzer into research analysts and potential conflicts of interest. *Id.* at 102.

155. NASDAQ NEWSROOM, *supra* note 154.

156. Charles Gasparino, *All-Star Analyst Faces Arbitration After Internet Picks Hit the Skids*, WALL ST. J., Mar. 2, 2001, at C18. Debases Kanjilal filed an arbitration with the NYSE against Merrill Lynch and Henry Blodget alleging that he purchased shares of InfoSpace Inc. through Merrill Lynch and continued to hold the position due to Mr. Blodget's "buy" recommendation. *Id.* (internal quotation marks omitted). Mr. Kanjilal stated that while he wanted to sell his shares when they began to decline in value, his Merrill Lynch broker recommended that he hold the shares because of a conversation the broker allegedly had with Mr. Blodget. *See id.* Additionally, Mr. Kanjilal alleged that Mr. Blodget was motivated to provide optimistic projections for InfoSpace Inc. because Merrill Lynch's investment banking department was the financial adviser for another company, Go2Net Inc., which InfoSpace Inc. purchased. *Id.* Mr. Kanjilal claimed that had the price of InfoSpace Inc. declined before the acquisition of Go2Net Inc., the transaction may have been "jeopardized." *See id.* Further, Mr. Kanjilal claimed that "[Mr.] Blodget's recommendations lacked a reasonable basis in fact and [Mr.] Blodget failed to disclose a serious conflict of interest with the company whose stock he was touting." *Id.* (internal quotation marks omitted).

matter.[157] While Merrill Lynch may have quelled one fire, only a few months later, N.Y. Attorney General Eliot Spitzer began investigating Merrill Lynch's investment banking group for "compromis[ing] the objectivity of the firm's [research] analysts."[158] In April 2002, Attorney General Spitzer announced a Martin Act proceeding[159] against Merrill Lynch.[160] Within weeks of announcing the investigation, the Attorney General reached a settlement with Merrill Lynch.[161]

Other Wall Street firms, while not the first to face scrutiny by regulators, soon became the subject of a joint investigation by the S.E.C., the National Association of Securities Dealers ("NASD"), the New York Stock Exchange ("NYSE"), and the N.Y. Attorney General.[162] The regulators alleged that investment bankers had an undue influence on securities research at brokerage firms.[163] The joint investigation culminated in what is now called the "Global Settlement."[164] In addition

157. Merrill Lynch and Mr. Blodget settled the matter in July 2001. *See* Charles Gasparino, *Merrill Is Paying in Wake of Analyst's Call on Tech Stock*, WALL ST. J., July 20, 2001, at C1. Merrill Lynch publicly stated that it settled the matter with Mr. Kanjilal to "avoid the expense and distraction of protracted litigation." *Id.* (internal quotation marks omitted).

158. Moses, *supra* note 145, at 100. The investigation was based upon a review of Merrill Lynch's internal emails which revealed that several analysts expressed "uncomplimentary views" regarding the investments they recommended as "buy" positions. *Id.* (internal quotation marks omitted).

159. *Id.* The Martin Act, a N.Y. securities statute, is intended to prevent fraud in connection with the sale of securities. N.Y. GEN. BUS. LAW §§ 352–353 (McKinney 1996). The N.Y. Attorney General has the power to commence an action and to order a trial court to direct respondents to appear and produce documents. *Id.* §§ 353–354.

160. *See* Press Release, Office of N.Y. Attorney Gen. Eliot Spitzer, Merrill Lynch Stock Rating System Found Biased by Undisclosed Conflicts of Interest (Apr. 8, 2002), http://www.ag.ny.gov/media_center/2002/apr/apr08b_02.html (announcing a court order requiring Merrill Lynch to "make disclosures to investors about its relationship with investment banking clients" pursuant to the Martin Act).

161. Moses, *supra* note 145, at 101. Merrill Lynch agreed to, among other things, pay a $100 million civil penalty, make detailed disclosures regarding ties between the investment banking department and the research analysts, and set up a Research Recommendation Committee whose function was to monitor the work of its analysts for objectivity. *Id.*; *see also* Stipulation at 3, 7, 9-10, 12, Eliot Spitzer v. Merrill Lynch, No. 02-401522 (N.Y. Sup. Ct. May 21, 2002), *available at* http://www.ag.ny.gov/bureaus/investor_protection/pdfs/merrill_agreement.pdf.

162. Press Release, U.S. Sec. & Exch. Comm'n, SEC, NY Attorney General, NASD, NASAA, NYSE and State Regulators Announce Historic Agreement to Reform Investment Practices; $1.4 Billion Global Settlement Includes Penalties and Funds for Investors (Dec. 20, 2002), http://www.sec.gov/news/press/2002-179.htm.

163. *Id.*

164. *Id. See also* Press Release, U.S. Sec. & Exch. Comm'n, Ten of Nation's Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking (Apr. 28, 2003), http://www.sec.gov/news/press/2003-54.htm [hereinafter Press Release for Enforcement Actions Against Investment Firms] (announcing the finalized "[G]lobal [S]ettlement" with ten Wall Street firms). The "Global Settlement" involved some of the largest Wall Street firms, including Bear Stearns & Co. Inc.; Goldman, Sachs & Co.; Lehman Brothers Inc.; Morgan Stanley & Co.; Merrill Lynch; J.P. Morgan Securities Inc.; and UBS Warburg LLC. *Id.*

to almost $1.4 billion in penalties and disgorgement, the firms were required to alter future practices related to their investment banking and research businesses.[165] Approximately $387.5 million paid by firms other than Merrill Lynch was placed in a fund for customer benefit in resolution of actions brought by the S.E.C., NASD, and NYSE.[166]

While the "Global Settlement" included an investor restitution fund, the settlement did not bar private civil lawsuits against the firms by customers harmed by the conflicts of interest.[167] In fact, the N.Y. Attorney General touted that his office had "made public the information that [investors] need to bring a lawsuit."[168] By November 2002, Merrill Lynch was facing over 150 arbitrations based primarily on research analyst conflicts.[169] Plaintiffs, while presumably provided with the information to bring lawsuits against brokerage firms and research analysts, still faced difficulty in establishing loss causation in analyst-conflict litigation.[170]

B. *Loss Causation in "Global Settlement" Litigation*

Analyst-conflict cases were generally brought under Section 10(b) and plaintiffs alleged that the research reports published by the defendants were materially false or misleading.[171] Plaintiffs alleged that because of the misleading research analyst reports, the market price for

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165. *See* Press Release for Enforcement Actions Against Investment Firms, *supra* note 165 (requiring separation of the investment banking and research departments at the firms as well as the review of research). Further, the firms were required to take measures to insulate research analysts from future undue influence by investment bankers in the following ways: (1) physically separating the departments; (2) requiring senior management to determine the research budget without input from investment bankers; (3) prohibiting any investment banking role in evaluating analysts or determining their compensation; and (4) requiring the managers of the research group alone to make all decisions to initiate or terminate company-specific coverage. *Id.*

166. *Id.*

167. Moses, *supra* note 145, at 103-04.

168. Interview by Hedrick Smith with Eliot Spitzer, N.Y. State Attorney Gen. (Apr. 16, 2003) (transcript *available at* http://www.pbs.org/wgbh/pages/frontline/shows/wallstreet/interviews/spitzer.html). Additionally, the Attorney General stated that "the information will let [investors] go to court and say, 'You lied to me, gave me fraudulent advice. Now pay up.'" *Id.*

169. Moses, *supra* note 145, at 104.

170. *See, e.g.*, *In re* Merrill Lynch & Co. Research Reports Sec. Litig., 289 F. Supp. 2d 416, 421 (S.D.N.Y. 2003) (holding that the "harm suffered by the plaintiffs was not caused by any alleged fraud of the defendants; rather, it was caused by the direct intervention of the crash of the internet bubble in the market for which the defendants were not responsible").

171. *See, e.g.*, Fogarazzo v. Lehman Bros., 263 F.R.D. 90, 95 (S.D.N.Y. 2009) (alleging that the defendants issued false and misleading analyst reports in violation of Section 10(b)). *See* Moses, *supra* note 145, at 104 ("Typically, the analyst-conflict class actions are brought under SEC Rule 10b-5, which prohibits fraud in connection with the purchase or sale of a security.").

the securities they purchased was artificially inflated, and the investors were injured because of the disparity between the inflated transaction price and the actual value of the security in question.[172] The analyst-conflict posed a difficult scenario for plaintiffs seeking to establish that misrepresentations by the defendants caused the inflation of the stock and that upon revealing the truth, the stock price declined and caused an economic loss.[173] The N.Y. Attorney General commenced the Martin Act proceeding against Merrill Lynch in April 2002, but the prices of Internet stocks (the securities generally at issue in the analyst-conflict complaints) began to decline after the Internet bubble burst in 2000.[174]

Consequently, Senior District Judge Milton Pollack of the Southern District of New York held that the general decline of the market due to the Internet bubble was a sufficient "intervening cause" to warrant the dismissal of several consolidated analyst-conflict cases against Merrill Lynch.[175] As a result, while the N.Y. Attorney General may have

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172. *See, e.g.*, *Fogarazzo*, 263 F.R.D. at 95 (alleging that because defendants issued false and misleading analyst reports on RSL Communications, Inc. ("RSL"), the market price of RSL was artificially inflated, and purchasers of the investment were injured as a result); *In re Merrill Lynch & Co.*, 289 F. Supp. 2d at 420 (alleging that because of misrepresentations and omissions by the defendants, the price of the securities were artificially inflated, creating a disparity between the purchase price and the market value of the investments).

173. *See* Moses, *supra* note 145, at 108-09. Proving loss causation for analyst-research conflict cases proved difficult:

> The situation is somewhat more complicated, however, in the world of analyst-research conflict litigation. In most such cases, the prices of the stocks at issue began dropping when the Internet bubble burst in 2000—two years before Merrill Lynch's internal emails were made public . . . and three years before similar materials from other firms were released in connection with the Global Settlement.

Id.

174. *Id.* at 109.

175. *See In re Merrill Lynch & Co.*, 289 F. Supp. 2d at 422 ("Where there is no proximate cause for the loss sustained other than the direct intervention of a market collapse, that collapse will govern on a Rule 12(b)(6) motion to dismiss."). Judge Pollack's holding was significant because most of the analyst-conflict cases were heard by district court judges in the Southern District of New York. *See* Moses, *supra* note 145, at 110-11 (describing the cases heard by judges in the Southern District of New York). *But see* Demarco v. Lehman Bros., 309 F. Supp. 2d 631, 636-37 (S.D.N.Y. 2004) (denying defendant broker-dealer's motion to dismiss in part because plaintiff investors had sufficiently pled that in October 2000, when "the market was finally apprised of the negative information [regarding the analyst-conflict], the stock declined, causing the losses"). The court makes no mention of the market decline associated with the Internet bubble. *See id.* Merrill Lynch later settled some of the consolidated cases against it relating to the analyst-conflict after the Second Circuit affirmed the dismissal of plaintiffs' claims in *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 164 (2d Cir. 2005). *See also In re* Merrill Lynch & Co. Research Reports Sec. Litig., No. 02 MDL 1484(JFK), 2007 WL 313474, at *3 (S.D.N.Y. Feb. 1, 2007) ("In 2005, following the Second Circuit's decision in *Lentell*, the parties began to conduct settlement negotiations."). In *Lentell*, the Second Circuit upheld the district court's holding that plaintiffs failed to plead that the misrepresentations and omissions caused the losses. *Lentell*, 396 F.3d at 164.

intended to provide plaintiffs with enough information to succeed in claims against the broker-dealers in analyst-conflict cases, the courts still held the proverbial "key to the castle" with respect to whether or not such cases could proceed.[176]

VI. LITIGATION AGAINST CREDIT RATING AGENCIES

Litigants have been unsuccessful in their attempts to bring private causes of action against credit rating agencies. Section A describes both the claims brought by litigants against credit rating agencies as well as the defenses the credit rating agencies raised in response to such claims. Section B explains future attempts to hold credit rating agencies liable. Additionally, Section C outlines the steps taken by the credit rating agencies to oppose the registration requirements of the Dodd-Frank Act.

A. Attempts to Hold Credit Rating Agencies Liable Prior to the Dodd-Frank Act

Prior to the passage of the Dodd-Frank Act, credit rating agencies were exempt from liability under the Securities Act through the promulgation of Rule 436(g).[177] If Rule 436(g) had not exempted credit rating agencies from liability, plaintiffs seeking to find credit rating agencies liable would have ideally brought causes of action under Section 11.[178] The exemption was significant because the federal laws are chock-full of rating-dependent laws and regulations.[179] While credit rating agencies were statutorily shielded from Section 11 liability, plaintiffs attempted to hold credit rating agencies liable under other

176. *See, e.g.*, *In re Merrill Lynch & Co.*, 289 F. Supp. 2d at 422 (dismissing investors' claims against Merrill Lynch because investors were unable to tie their losses directly to the misrepresentations made by the research analysts).

177. *See supra* Part III.D.2.

178. *See* Securities Act of 1933, 15 U.S.C. § 77k(a)(4) (2006) (creating civil liability for untrue statements of material fact in registration statements by persons who have "prepared or certified any part of the registration statement, or . . . prepared or certified any report or valuation which is used in connection with the registration statement").

179. For example, the Federal Deposit Insurance Act states that corporate debt securities are not investment grade unless they are rated in one of the four highest categories by at least one NRSRO. Federal Deposit Insurance Act, 12 U.S.C. § 1831e(d)(4)(A) (2006). Additionally, S.E.C. rules regarding minimum capital requirements of broker-dealers were based on NRSRO ratings until the S.E.C. adopted amendments to several rules referencing NRSROs. *See Rules and Forms at Issue in Removal of References to NRSRO Credit Ratings*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/news/press/2009/2009-200-rulesformsaffected.htm (last modified Sept. 18, 2009).

theories.[180] Plaintiffs have generally been unsuccessful in holding credit rating agencies liable under other theories of liability.[181]

1. Types of Claims Brought Against Credit Rating Agencies

Prior to the enactment of the Dodd-Frank Act, plaintiffs generally brought claims against credit rating agencies for fraud in violation of federal securities laws such as Rule 10b-5[182] and state tort law.[183] For example, in *In re Moody's Corp. Securities Litigation*,[184] class action plaintiffs alleged that the credit rating agency made material misrepresentations and omissions in public statements regarding

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180. In *Abu Dhabi Commerical Bank v. Morgan Stanley & Co.*, two institutional investors brought a class action against the investment bank and credit rating agencies Moody's and S & P (who rated the investment as a "condition precedent to purchase") under theories of common law fraud, negligent misrepresentation, negligence, breach of fiduciary duty, breach of contract, and other contract claims. 651 F. Supp. 2d 155, 163-64 (S.D.N.Y. 2009). Some plaintiffs have brought claims against credit rating agencies under Section 11(a)(5) as "underwriter[s]" rather than experts. *See, e.g.*, *In re* Lehman Bros. Sec. & ERISA Litig., 681 F. Supp. 2d 495, 497-98 (S.D.N.Y. 2010), *aff'd sub nom. In re* Lehman Bros. Mortg.-Backed Sec. Litig., 650 F.3d 167 (2d Cir. 2011) (alleging that the offering documents for the mortgage-backed securities at issue did not disclose that the credit rating agencies had "largely determined the composition of the securitized pool of loans" and that there were conflicts of interest between the issuer, Lehman Brothers, and the credit rating agencies). Other plaintiffs have brought claims alleging violations of Rule 10b-5. *See, e.g.*, *In re* Moody's Corp. Sec. Litig., 599 F. Supp. 2d 493, 501, 503 (S.D.N.Y. 2009) (alleging that Moody's made false statements regarding its independence from the issuers and made misrepresentations in statements regarding the integrity of the rating agency's ratings).

181. Courts have held that credit rating agencies are not "underwriters":

> The Rating Agencies' alleged activities may well have had a good deal to do with the composition and characteristics of the pools of mortgage loans and the credit enhancements of the [investments at issue] that ultimately were sold. But there is nothing in the complaint to suggest that [the credit rating agencies] participated in the relevant "undertaking" . . . .

In re Lehman Bros., 681 F. Supp. 2d at 499. *See also* Quinn v. McGraw-Hill Cos., 168 F.3d 331, 332, 334-35 (7th Cir. 1999) (holding that reliance on ratings was unreasonable because the plaintiff, a majority shareholder in two small banks, failed to show that he was a third-party beneficiary of the contract between the issuer and the credit rating agency); First Equity Corp. v. Standard & Poor's Corp., 869 F.2d 175, 176, 178-79 (2d Cir. 1989) (holding that plaintiffs, investors and an investment advisory firm, could not recover damages caused by their reliance on a misrepresentation in the credit rating agency's publication but the court refused to reach the issue of whether the rating agencies would be liable under a First Amendment analysis). *See also* Thomas J. Pate, *Triple-A Ratings Stench: May the Credit Rating Agencies Be Held Accountable?*, 14 BARRY L. REV. 25, 44 (2010) ("Most of the past cases brought against [credit rating agencies] have failed on the basis of the argument that they are members of the press and that their ratings are protected under the heightened actual malice standard."). The First Amendment defense raised by credit rating agencies is discussed *infra* Part VI.A.2.

182. *See, e.g.*, *In re Moody's Corp.*, 599 F. Supp. 2d at 507 (bringing claims of material misrepresentations and omissions in public statements under Rule 10b-5).

183. *See, e.g.*, *Abu Dhabi*, 651 F. Supp. 2d at 163 (bringing claims of common law fraud, negligent misrepresentation, negligence, breach of fiduciary duty, breach of contract, and related claims such as unjust enrichment and aiding and abetting).

184. 599 F. Supp. 2d 493 (S.D.N.Y. 2009).

Moody's business and independence, the meaning of the agency's credit ratings, and the methodology of Moody's credit ratings.[185] The court denied the credit rating agency's motion to dismiss the claims and held that the question of an "intervening cause" was a matter for trial.[186] Subsequently, upon plaintiffs' motion to certify the class, the court held that the there was no time within the class period where the alleged misrepresentations by the credit rating agency caused a "statistically significant" increase in price.[187]

Some plaintiffs have attempted to hold credit rating agencies liable under the "underwriter" provision of Section 11.[188] In 2010, Judge Kaplan of the Southern District of New York held in *In re Lehman Bros. Securities & ERISA Litigation*[189] that credit rating agencies are not underwriters under the statutory definition of the term and, as a result, were not liable under Section 11.[190] Plaintiffs brought a class action suit against Lehman Brothers Holdings, Inc. ("Lehman"), Moody's, and S & P for over ninety offerings involving mortgage-backed securities pooled together and sold to a common law trust.[191] The securities were registered with the S.E.C. as required and prospectuses and prospectus supplements (the "Offering Documents") were also filed with the S.E.C.[192] Plaintiffs alleged that information contained in the Offering Documents were materially false and misleading.[193] With respect to the claims against Moody's and S & P, the plaintiffs alleged, *inter alia*, that the Offering Documents failed to disclose that the credit rating agencies had played a significant role in determining the composition of the pool

185. *Id.* at 499.

186. *Id.* at 513-14.

187. *In re Moody's Corp. Sec. Litig.*, 274 F.R.D. 480, 484, 493 (S.D.N.Y. 2011). The defendants bore the burden of "sever[ing] the link between the alleged misrepresentation and the price" in order to "rebut the presumption of reliance" upon the misrepresentations. *Id.* at 490.

188. *See, e.g.*, *In re* Lehman Bros. Sec. & ERISA Litig., 681 F. Supp. 2d 495, 499 (S.D.N.Y. 2010), *aff'd sub nom. In re* Lehman Bros. Mortg.-Backed Sec. Litig., 650 F.3d 167 (2d Cir. 2011).

189. 681 F. Supp. 2d 495, 499 (S.D.N.Y. 2010).

190. *Id.* at 498-99. The statute defines "underwriter" as:

> [A]ny person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission.

Securities Act of 1933, 15 U.S.C. § 77b(a)(11) (2006).

191. *In re Lehman Bros.*, 681 F. Supp. 2d at 496-97.

192. *Id.* at 497.

193. *Id.*

of loans and that there were material undisclosed conflicts of interest between Lehman and the agencies.[194]

Judge Kaplan held that while the efforts of the credit rating agencies were necessary for Lehman to issue the mortgage-backed securities, the complaint failed to establish that the credit rating agencies were underwriters who had purchased the securities "from the issuer with a view to their resale."[195] The honorable jurist emphasized that "[m]any actors, quite likely including the Rating Agencies, contributed to the catastrophe" of the mortgage-backed securities market collapse, but held that the responsibility for the court was to "compare this complaint with the law governing liability on the particular legal theories selected by the plaintiffs."[196]

Judge Kaplan's decision was made in February 2010, prior to the passage of the Dodd-Frank Act and the newly created cause of action against credit rating agencies. As a result, his holding does not foreclose the possibility that credit rating agencies will be held liable in the future, or at the very least that plaintiffs will seek to hold the credit rating agencies liable under Section 11.[197] One of the most significant obstacles to plaintiffs bringing suits against credit rating agencies under Section 11 will be the ability of defendants to assert the absence of loss causation as an affirmative defense,[198] similar to the broker-dealer defendants in the "Global Settlement" litigation.[199]

2. Non-Mitigation Defenses Raised by Credit Rating Agencies

Credit rating agencies have generally been successful in asserting various defenses to claims by investors seeking to hold them accountable for their ratings.[200] Credit rating agencies raise integrity defenses, including: (1) the reputation defense; and (2) the First Amendment

194. *Id.*

195. *Id.* at 498-99 (internal quotation marks omitted). Plaintiffs also claimed that the credit rating agencies should be held liable under Section 12(a)(2) as sellers. *Id.* at 499. Judge Kaplan found that the argument was unpersuasive in light of the Supreme Court's decision in *Pinter v. Dahl*, holding that seller liability under the provision was reserved for those that "pass title or 'successfully solicit[] the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner.'" *Id.* at 499-500 (citing Pinter v. Dahl, 486 U.S. 622, 647 (1988)).

196. *Id.* at 501.

197. *See infra* Part VI.B.2.

198. *See supra* Part IV.B.

199. *See supra* Part V.B.

200. *See* Sherrie R. Savett, *Plaintiffs' Vision of Securities Litigation: Current Trends and Strategies*, *in* SECURITIES LITIGATION AND ENFORCEMENT INSTITUTE 2010, at 523, 565 (PLI Corporate Law & Practice, Course Handbook Ser. No. 23726, 2010) (explaining that credit rating agencies have been able to avoid liability by asserting legal defenses).

defense.[201] Litigation brought against credit rating agencies has generally failed based on the argument that the agencies are members of the press and their ratings are opinions, thus protected under the First Amendment.[202] Under *New York Times Co. v. Sullivan*,[203] ratings issued by credit rating agencies may be protected under a heightened malice standard.[204] While the defense is generally successful, at least one court has attempted to make a distinction between solicited and unsolicited ratings.[205] Additionally, the Second Circuit found that the credit rating agency's "fairly active role . . . in commenting on proposed transactions and offering suggestions about how to model the transactions to reach the desired ratings" warranted a holding that the credit rating agency was not protected under the First Amendment.[206] Additionally, some commentators suggest that the First Amendment defense will not be successful in cases brought as a result of the subprime mortgage crisis.[207]

B. *Future Attempts to Hold Credit Rating Agencies Liable*

As discussed, Section 939G of the Dodd-Frank Act has opened a potential path for litigants to bring private causes of action against credit

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201. *See* David J. Grais & Kostas D. Katsiris, *Not "The World's Shortest Editorial": Why the First Amendment Does Not Shield the Rating Agencies from Liability for Over-Rating CDOs*, BLOOMBERG L. REP., Nov. 12, 2007, at 40, 40 (explaining the First Amendment defense); Lynch, *supra* note 39, at 250 (explaining the reputation defense).

202. *See* Pate, *supra* note 181, at 44-46 (describing the First Amendment cases involving credit rating agencies). Credit rating agencies have argued:

> [T]hat their ratings are "opinions" with regard to the creditworthiness of the rated entity and thus are protected by the First Amendment. This view is shared by leading experts on the U.S. Constitution who believe that credit rating agencies are protected so long as they are not paid to write positive reviews (as opposed to reviews generally), and so long as they are communicating to the public rather than to a few private subscribers or to a particular entity that hires them to give individualized advice.

Bai, *supra* note 87, at 287 (footnotes omitted).

203. 376 U.S. 254 (1964).

204. *See id.* at 283; Pate, *supra* note 181, at 44.

205. *See* Pate, *supra* note 181, at 45. The author discussed *Commercial Financial Services v. Arthur Andersen*, where the Court held that the First Amendment did not protect the credit rating agency because the issuer had requested the rating and the agency had a "duty of care to provide accurate ratings." *Id.* (citing Commercial Fin. Servs., Inc. v. Arthur Andersen LLP, 94 P.3d 106, 112 (Okla. Civ. App. 2004)).

206. Grais & Katsiris, *supra* note 201, at 41 (internal quotation marks omitted).

207. *See, e.g.*, *id.* at 44 (concluding that the level of a credit rating agency's involvement in structuring a security may place a credit rating agency in the position of losing a First Amendment defense). *But see* Karen Gullo, *Ratings by Moody's, Fitch, S&P Ruled to Be Protected Speech*, BLOOMBERG (Dec. 11, 2010, 12:02 AM), http://www.bloomberg.com/news/2010-12-10/moody-s-fitch-s-p-ratings-are-protected-speech-california-judge-rules.html (describing the recent dismissal of a case against the credit rating agencies under state law freedom of speech protections where the plaintiffs alleged that the ratings of structured investments in the California Public Employees' Retirement System were "wildly inaccurate" (internal quotation marks omitted)).

rating agencies.[208] While the Dodd-Frank Act may have statutorily created a cause of action for litigants, the ability for such cases to move forward remains in the hands of the judiciary.

1. The Impact of Section 11 Liability After the Dodd-Frank Act

The Dodd-Frank Act, by permitting credit rating agencies to be held liable under Section 11, has opened a previously foreclosed avenue for plaintiffs to hold rating agencies liable.[209] The Act statutorily enhanced liability of credit rating agencies by repealing Rule 436(g).[210] Credit rating agencies, as non-issuer defendants, will still be able to assert various affirmative defenses such as due diligence and loss causation.[211] While the Act creates a new private cause of action, it remains to be seen whether the judiciary will in fact adhere to the statutorily created cause of action.[212]

2. Judicial Reaction to Section 11 Liability against Credit Rating Agencies: Students of History or Pioneers?

While plaintiffs will not be required to plead loss causation in actions brought under Section 11,[213] as demonstrated in litigation brought as a result of the "Global Settlement," it may be difficult for plaintiffs to prove that their losses were caused by misstatements or omissions on registration statements rather than the overall decline in the market stemming from the economic crisis.[214]

In *In re Moody*'s, the credit rating agency very explicitly raised the "intervening cause" defense.[215] According to Moody's, plaintiffs made "scarce mention of the collapse of the structured finance market" and argued that the judge was permitted to take "judicial notice" of the

208. *See supra* Part III.D.2.

209. *See supra* Part III.D.2.

210. Coffee, *supra* note 17, at 27; *see supra* Part III.D.2.

211. *See supra* Part IV.B.

212. *See* Coffee, *supra* note 17, at 27 (arguing that while the Act enhances liability for credit rating agencies: "a Constitutional question mark still hangs over this area that could nullify this new liability provision"). Specifically, credit rating agencies will likely continue to argue that their ratings are opinions protected under the First Amendment and may be successful. *See, e.g.*, Gullo, *supra* note 207 (discussing a December 2010 case against Moody's, S & P, and Fitch that was dismissed under a state freedom of speech law).

213. Securities Act of 1933, 15 U.S.C. § 77k(a)(1)–(5) (2006) (listing the requirements for liability but not requiring "loss causation"). *See* text accompanying note 136.

214. *See, e.g.*, *In re* Merrill Lynch & Co. Research Reports Sec. Litig., 289 F. Supp. 2d 416, 421 (S.D.N.Y. 2003) ("[H]arm suffered by the plaintiffs was not caused by any alleged fraud of the defendants; rather, it was caused by the direct intervention of the crash of the internet bubble in the market for which the defendants were not responsible.").

215. Memorandum of Law of Defendants, at 19, *In re* Moody's Corp. Sec. Litig., 599 F. Supp. 2d 493 (S.D.N.Y. 2009) (No. 1:07-CV-8375-SWK).

decline in the market,[216] exactly as the court had done in *In re Merrill Lynch & Co.*[217] Moody's argued that the collapse of the structured finance market caused plaintiffs' losses.[218] Moody's also argued that the plaintiffs' failed to allege a correlation between the misrepresentation and the decline of the investment, and as a result, "only the intervening cause, the burst of the [market] bubble," could account for such losses.[219]

In 2010, Judge Shira Scheindlin of the Southern District of New York specifically discussed the "intervening cause" of the economic crisis in her holding in *King County, Washington v. IKB Deutsche Industriebank AG.*[220] Judge Scheindlin refused to dismiss claims by two institutional investors against Moody's, S & P, and Fitch, who rated the structured investment vehicle Rhinebridge.[221] The investors alleged that the credit rating agencies had fraudulently misrepresented the value of Rhinebridge between June 2007 and October 2007 by assigning the Rhinebridge Senior Notes high credit ratings.[222] Plaintiffs alleged that the high credit ratings concealed that Rhinebridge consisted of "toxic assets that were heavily concentrated in the structured finance and subprime mortgage industries and thus likely to default."[223] After issuing high credit ratings to the Senior Notes, the credit rating agencies downgraded the Senior Notes to "junk" status and, as a result, those holding the notes suffered millions in damages.[224]

The credit rating agencies claimed that the credit crisis, not risk concealed by creditworthy ratings, caused the plaintiffs' losses.[225] Judge Scheindlin discussed at length the "Global Settlement" litigation that focused on the marketwide decline when the Internet bubble burst in 2000.[226] While holding that the plaintiffs did not fail to plead loss causation because the credit crisis "occurred contemporaneously" with the "collapse" of the investment,[227] Judge Scheindlin conceded that the

216. *Id.* at 11.

217. *See In re Merrill Lynch & Co.*, 289 F. Supp. 2d at 421. *See also* notes 175-76.

218. Memorandum of Law of Defendants, *supra* note 215, at 19.

219. *Id.* at 20 (alteration in the original). Additionally, Moody's cited to cases that occurred during other downturns in the market where courts held that "intervening causes" were the reason for plaintiffs' injuries. *Id.*

220. King County v. IKB Deutsche Industriebank AG, 708 F. Supp. 2d 334, 335, 342-44 (S.D.N.Y. 2010) (internal quotation marks omitted).

221. *Id.* at 335-36, 346.

222. *Id.* at 336.

223. *See id.*

224. *Id.* at 337 (internal quotation marks omitted).

225. *See id.* at 340. As part of their defense, the credit rating agencies provided a list of the various courts that had taken judicial notice of the economic crisis. *Id.* at 340 n.42.

226. *Id.* at 342-43.

227. *Id.* at 343.

economic crisis may "break the chain of causation when considered in a different factual context."[228] The ultimate outcome of the case may be pivotal in future litigation against credit rating agencies. If courts begin to dismiss claims at the summary judgment phase because of an absence of loss causation, the statutorily created cause of action under Section 11 against credit rating agencies may be dead on arrival.

C. *Credit Rating Agencies and Measures Taken Against the New Dodd-Frank Act Registration Statement Requirements*

Immediately following the enactment of the Dodd-Frank Act, credit rating agencies expressed their unwillingness to comply with the requirement that they consent to being named as experts in registration statements—significantly affecting the ability of issuers to offer investments to the market.[229] Further, credit rating agencies have argued that requiring their consent to use their ratings in registration statements would have significant consequences, including less disclosure, because they will refuse to consent to the inclusion.[230] The S.E.C. responded by permitting asset-backed issuers to omit the ratings disclosure from prospectuses related to asset-backed securities until January 24, 2011.[231]

The S.E.C. has not extended the six-month timeframe for issuers past the January 24, 2011 deadline and has begun issuing additional disclosure rules related to asset-backed securities—suggesting that the agency is moving forward with the rulemaking process related to markets that affect NRSROs directly.[232] As a result, it appears that the S.E.C. is continuing to take steps to ensure its regulatory hold on credit rating agencies while the courts begin to determine the extent of liability that will be imposed on rating agencies through private causes of action.[233]

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228. *Id.* at 343 n.64 (discussing other cases that dismissed plaintiffs' complaints for failure to plead loss causation because the plaintiffs did not adequately show that other circumstances of the market had not caused the decline in the security price).

229. *See, e.g.*, Letter from Susan J. Thomas, *supra* note 66.

230. *Credit Rating Agency Consents Required for Inclusion of Ratings in Registration Statements: The Repeal of Rule 436(g) and Subsequent SEC Guidance*, FRIED FRANK, 1 (Aug. 2, 2010), http://www.friedfrank.com/siteFiles/Publications/9BBB0D90DC906E7EE3184DDEC4B96720.pdf. Additionally, credit rating agencies have argued that should they choose to consent to ratings and that the increased costs of conducting due diligence prior to consent would lead to fewer offerings. *Id.* at 2.

231. Response from Katherine Hsu, *supra* note 66.

232. *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Approves New Rules Regulating Asset-Backed Securities (Jan. 20, 2011), http://sec.gov/news/press/2011/2011-18.htm (explaining the adoption of two sets of rules encouraging disclosure, including disclosure by NRSROs, in the asset-backed securities markets).

233. *See King County*, 708 F. Supp. 2d at 343.

VII. RESOLUTION

Congress's attempt through the repeal of Rule 436(g) in the Dodd-Frank Act to hold credit rating agencies liable in the wake of the agencies' substantial role in the economic crisis is admirable. The statutory cause of action, while a commendable first step, must find teeth in the judiciary in order to make an impact. The statutory language, if strengthened, may create the cause of action that Congress intended—a private cause of action that would at least make a dent and one that would make the courts take notice.

A. Issues with the New Legislation

While Congress should be applauded for at least attempting to create a private cause of action against credit rating agencies, the newly created cause of action may not be a viable method for recovery. While plaintiffs will not have to prove loss causation for fraud actions brought under the lower burden of Section 11, credit rating agencies will inevitably assert loss causation as an affirmative defense.[234] Once the loss causation defense is asserted, plaintiffs will have a difficult time proving that an "intervening cause," such as the worldwide market decline, did not cause the plaintiff's damages.[235] As a result, the newly created cause of action in the Dodd-Frank Act will be ineffective in establishing a basis for plaintiffs to seek damages against credit rating agencies. Congressional intent to hold credit rating agencies accountable in the same manner as auditors, securities analysts, or public accounting firms falls short if the method for such accountability is unsuccessful.[236]

B. Proposed Resolution

The Dodd-Frank Act should be amended to provide clearer guidance with respect to loss causation. To accomplish Congress's intent to protect investors and hold credit rating agencies liable for their part in the economic crisis, Section 11 should be amended to include a

234. *See supra* Part VI.B.2.

235. *See, e.g.*, *In re* Merrill Lynch & Co. Research Reports Sec. Litig., 289 F. Supp. 2d 416, 420-21 (S.D.N.Y. 2003).

236. *See* Securities Act of 1933, 15 U.S.C. § 77k(a)(4) (2006) (establishing liability for untrue statements of material fact or omissions in registration statements against "any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement"); Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 931(3), 124 Stat. 1376, 1872 (2010) ("[C]redit rating agencies are fundamentally commercial in character and should be subject to the same standards of liability and oversight as apply to auditors, securities analysts, and investment bankers.").

provision that prohibits credit rating agencies from asserting the absence of loss causation as an affirmative defense in private causes of action.[237] While Section 939G of the Dodd-Frank Act repeals Rule 436(g), an amendment should be made to Section 11 of the Securities Act to ensure that the private cause of action created by Dodd-Frank is more than just words that appear on paper and becomes effective in reality. Currently, relevant portions of the mitigation defense or "intervening cause" section of Section 11 of the Securities Act reads as follows:

> [I]f the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable.[238]

The following language should be added after "recoverable" in the above-quoted statutory language to address the loss causation defense discussed throughout this Note:

> In the case of litigation brought against credit rating agencies or nationally recognized statistical rating organizations under this Section, the defendant-credit rating agencies or nationally recognized statistical rating organizations cannot use an intervening cause, such as a general economic downturn, as a defense to liability.

The above language would accomplish what Congress set out to establish—a statutorily created cause of action against credit rating agencies under the federal securities laws that cannot be impeded by credit rating agencies seeking to use the economic downturn as an affirmative defense—especially when credit rating agencies had such a significant role in the economic crisis. The amendment, while affording credit rating agencies the opportunity to assert due diligence or First Amendment defenses, would prohibit defendants from raising the mitigation defense that is beginning to create a roadblock for plaintiffs seeking to recover damages from credit rating agencies for inaccurate and inflated ratings.[239]

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237. *See, e.g.*, *In re Merrill Lynch & Co.*, 289 F. Supp. 2d at 421. If judges were not permitted to take into account "intervening causes" (such as the world-wide economic crisis), the private cause of action against credit rating agencies would be more effective in attaining Congress's goal of holding credit rating agencies accountable in the same manner as other actors in the financial markets.

238. 15 U.S.C. § 77k(e).

239. *See, e.g.*, *In re Merrill Lynch & Co.*, 289 F. Supp. 2d at 421 (finding that the economic

VIII. CONCLUSION

Enhanced regulation of credit rating agencies and the creation of a private cause of action against these agencies were inevitable as a result of their role in the economic crisis.[240] Regulation, however, must be implemented with an ultimate and *attainable* goal in mind.[241] While Congress's rush to action in the face of economic turmoil is commendable, mere action without serious contemplation about the effects of legislation leads to unintended and sometimes detrimental consequences.[242]

While an increase in litigation related to credit rating agency liability may seem likely, a historical analysis reveals that the new cause of action may not yield the intended results.[243] As in the cases brought against brokerage firms related to the "Global Settlement," plaintiffs bringing claims against credit rating agencies under Section 11 are likely to have a difficult time responding to the inevitable absence of loss causation defense that will be raised by credit rating agencies.[244] As history has shown, even when regulators hand plaintiffs the information necessary to bring causes of action against players in the financial markets (*a la* N.Y. Attorney General Spitzer's public comments that his office had "made public the information that [investors] need to bring a lawsuit"),[245] it appears that the judiciary will have the ultimate say as to whether cases under Section 11 against credit rating agencies are successful.[246]

In order to solidify the effect of the private cause of action against credit rating agencies, Congress should have stated with specificity the ability of litigants to bring claims against credit rating agencies without

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crisis was a sufficient "intervening cause" to prevent recovery by plaintiffs).

240. *See supra* Part II.A, III.B.

241. *See supra* Part II.C.

242. *See* Barack Obama, Op-Ed., *Toward a 21st-Century Regulatory System*, WALL ST. J., Jan. 18, 2011, at A17 (discussing the January 18, 2011 Executive Order, titled Improving Regulation and Regulatory Review, that requires federal agencies to ensure regulations both protect society and promote economic growth). According to the President, the motivation for the Executive Order was that "[s]ometimes, those rules have gotten out of balance, placing unreasonable burdens on business—burdens that have stifled innovation and have had a chilling effect on growth and jobs. At other times, we have failed to meet our basic responsibility to protect the public interest, leading to disastrous consequences." *Id.*; *see supra* Part II.C.

243. *See, e.g.*, *The "Rushed Debate," supra* note 27, at 156 ("[C]ourts have refused to dismiss pending RICO claims based solely upon their reading of the RICO Amendment" requiring such dismissal.).

244. *See supra* Part IV.B.

245. Interview by Hedrick Smith with Eliot Spitzer, *supra* note 168.

246. *See supra* VI.B.2.

permitting loss causation as an affirmative defense.[247] In light of the Financial Crisis Inquiry Commission's conclusions that the credit rating agencies were among the main actors to blame for the economic crisis,[248] statutorily restricting the ability for credit rating agencies to use the worldwide market crash to avoid liability is reasonable.

To resolve this dilemma, Section 11 should be amended to reflect that the absence of loss causation cannot be used by credit rating agencies as an affirmative defense.[249] Only then will the newly created cause of action against credit rating agencies have the effect of imposing liability on those financial actors that played a significant role in the economic crisis. Until Congress takes additional steps to ensure that the statutorily created cause of action will accomplish its purpose, the Dodd-Frank Act will continue to be a game of horseshoes and hand grenades and "almost" an attack on credit rating agencies.

*Allana M. Grinshteyn**

247. *See supra* Part VII.B.

248. *See* FIN. CRISIS INQUIRY COMM'N, *supra* note 16, at xxv ("[T]he failures of credit rating agencies were essential cogs in the wheel of financial destruction.").

249. *See supra* Part VII.B.

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