Alison Frankel's **ON THE CASE**

Chicago judge okays AG suit vs S&P. Bad omen for rating agencies?

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This has not been a good week for Standard & Poor's. Stock in S&P's parent company, McGraw Hill, took a dive Monday after an Australian judge ruled that S&P is liable to investors for its misleading ratings of collateralized debt obligations. On Wednesday morning in federal court in New York, rating agency nemesis **Shira Scheindlin** -- the U.S. district judge presiding over two institutional investor fraud cases against the agencies and Morgan Stanley -- agreed to reconsider some previous rulings in favor of the defendants. And then Wednesday afternoon, a state court judge in Chicago ruled that Illinois Attorney General **Lisa Madigan**can proceed with her claim that S&P engaged in deceptive business practices when it told the investing public that its ratings of complex structured finance products were objective and independent.

The AG's suit, filed last August, asserts that the rating agency represented itself to be an independent evaluator of the securities, even though it often worked hand-in-glove with issuers to come up with a rating. According to the AG, S&P's "issuer pays" business model, in which the agency is hired by issuers to deliver a rating, compromised its independence and objectivity, so the rating agency's public assurances to the contrary violated that state's deceptive trade practices act.

S&P moved to dismiss the case on several grounds, including an argument that state-law claims against S&P are pre-empted by federal regulation of the rating agencies. The agency's most substantive defense was that the AG's case was based on statements that are either opinions protected under the First Amendment or generalities that don't amount to actionable representations.

Cook County Judge **Mary Ann Mason**, in a very clearly written decision, firmly rejected both of those arguments (as well as every other defense S&P raised). First of all, she said, the AG's suit isn't based on S&P's actual ratings of publicly traded securities (which are generally considered to be protected opinions) but on S&P's representations about its independence and objectivity. And those representations, she said, are not mere puffery. "These are not generalities or vague assurances; rather, they are verifiable representations regarding the manner in which S&P assures the integrity and independence central to the credibility of its ratings," she wrote.

To hold otherwise, Mason said, would be to immunize rating agencies from responsibility for assuring the public that they are what they claim to be. "A rating agency's existence depends on the investing public's confidence in the credibility and independence of its ratings," she wrote, in a nice summation of why investors have been so frustrated by their general inability to es t ablish a route to liability against the agencies. "Without that confidence, investors do not make investment decisions predicated upon the rating assigned to a particular security, those ratings lose their value to issuers, and issuers lack motivation to seek out that agency's rating in the future."

Mason's reasoning is certainly alluring, but I'm not convinced that it opens the floodgates for similar actions by other state AGs armed with state deceptive practices laws. Here's why: It turns out that AG Ma d igan's theories have been kicking around for a while, and have already gotten some traction elsewhere. Mason's opinion cited two such cases. Last March, a Connecticut state court judge refused to dismiss the state AG's case against Moody's, which raised the same kind of state-law allegations as Madigan's suit against S&P. (Connecticut also brought a case against S&P.) Even earlier, a class of Moody's investors asserted in federal court in Manhattan that the rating agency misrepresented the independence and objectivity of its ratings, to the detriment of its own investors. Their claims survived a Moody's motion to dismiss way back in 2009. Both the Connecticut AG's rating agency litigation and the Moody's class action continue to be litigated.

Meanwhile, federal regulation of rating agencies began in 2007, which gives the agencies a strong argument for federal pre-emption of state-law claims after that date. Claims based on pre-2007 conduct are bumping up against even the most generous state-law statutes of limitations. So if any state AGs are hoping to take advantage of Mason's ruling, they'd better hurry up.

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An S&P representative sent me a statement on the Chicago ruling: "The judge's decision to allow the action to proceed is simply a preliminary procedural ruling and does not address the merit of the Attorney General's allegations. We will continue to defend the action vigorously and expect the court will ultimately find the claims to be unfounded."

(This article has been corrected. A previous version misreported the plaintiff in the Australia case against S&P.)

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