December 14, 2009

By Electronic Mail
Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Concept Release on Possible Rescission of Rule 436(g) Under the Securities Act of 1933 (File No. S7-25-09) (the "Concept Release") and Credit Ratings Disclosure (File No. S7-24-09) (the "Disclosure Proposal")

Dear Ms. Murphy:

We write in our capacity as legal consultants to Moody's Investors Service ("MIS") in response to the Commission's request for comment on its Concept Release considering whether to rescind the Commission's Rule 436(g) and its parallel Disclosure Proposal to require issuer disclosure of information regarding credit ratings used by registrants. In our view, the two initiatives, if both adopted, would violate the First Amendment of the U.S. Constitution and contravene the 1933 Securities Act.

I. Summary

The Rules under consideration by the Commission relate to the credit ratings issued by Nationally Recognized Statistical Ratings Organizations ("NRSROs"). As the federal courts have consistently recognized, those ratings receive the full protections of the First Amendment because they address matters of public concern. Ratings may constitutionally be subject to liability only if the plaintiff proves that the NRSRO not only issued a "false" statement but knew its statement was false or, at the very least, actually harbored serious doubts regarding its truth.

The Supreme Court adopted this standard to protect against the prospect that holding publishers liable for unintentional mistakes would chill the free expression that the First Amendment was designed to protect. *N.Y. Times, Co.. v. Sullivan*, 376 U.S. 254, 266 (1964). The fact that ratings address a commercial issue (credit risk) and are financed by fees paid by issuers does not diminish the Constitution's protections. The category of "commercial speech" subject to lessened First Amendment protections instead is limited to promotional advertising. NRSRO ratings, by contrast, are independent evaluations that do not propose any transaction.

The Concept Release and Disclosure Proposal, if adopted together by the Commission, violate the First Amendment because they would subject NRSRO ratings to liability under Section 11 of the 1933 Securities Act. The Commission's Rule 436(g) presently exempts NRSROs from Section 11, which provides that an "expert" is liable for an error in a "report" used in a registration statement, unless the expert affirmatively proves that it was not negligent and instead used due care. That standard is a far cry from the "actual malice" standard required under the First Amendment.

It is no answer that a NRSRO can nominally withhold its "consent" to the use of its ratings in registration statements and thereby avoid liability under Section 11. Under the Commission's Disclosure Proposal, the NRSRO can do so as a practical matter only at the cost of going out of business, which is a burden that the First Amendment does not permit the government to impose as the cost of free speech. *United States v. National Treasury Employees Union*, 513 U.S. 454, 468 (1995) (citing *Simon & Schuster, Inc. v. Members of N.Y. State Crime Victims Bd.*, 502 U.S. 105 (1991)). The Disclosure Proposal provides that any "use" of a rating – defined broadly to include any communication relating to the offering – triggers an obligation to include the rating in the registration statement. But pursuant to Section 7 of the 1933 Act, the issuer cannot do so without the NRSRO's "consent." The effect of the Disclosure Proposal will thus be to force issuers to *require* a NRSRO to nominally "consent" as a precondition to the issuer either soliciting the rating or subscribing to a ratings service. Absent the NRSRO's acquiescence to that condition, the rating is of no use to the issuer. Thus, the Disclosure Proposal and Concept Release deprive NRSROs of any genuine ability to avoid the application of Section 11.

For closely related reasons, the Rules themselves violate the 1933 Securities Act. *See Chevron v. National Resource Defense Council*, 467 U.S. 837 (1984). In both Sections 7 and 11, Congress provided that an expert could avoid liability by withholding its "consent" to the use of its report in a registration statement. The plain meaning of the term "consent" connotes a voluntary choice. *See, e.g.*, THE OXFORD ENGLISH DICTIONARY 760-61 (2d ed. 1989). The Commission's Rules, by contrast, vitiate NRSROs' voluntary choice whether to grant or withhold permission for this use of their ratings. The Commission would leave NRSROs with only the alternative of ceasing to function as economically viable entities.

The Commission's Concept Release and Disclosure Proposal, if adopted together, accordingly violate the First Amendment and are invalid as contrary to the 1933 Securities Act.

II. The Rules Under Consideration Violate the First Amendment.

A. Credit Ratings Are Fully Protected by the First Amendment.

As described in more detail in parallel comments submitted by MIS, credit rating agencies such as MIS produce and publish independent analyses of financial investment instruments. Just as *Car and Driver* evaluates cars and the *New York Times* reviews movies, NRSROs evaluate the credit risk of securities. NRSROs publish sophisticated, independent judgments about credit risk generated from their analysis of vast amounts of data based on the rigorous analytic methodologies they have developed.

It is therefore unsurprising that courts have applied basic First Amendment precepts to afford NRSRO ratings the full protection of the Constitution's free speech guarantee. *E.g.*, *Compuware Corp. v. Moody's Investors Servs., Inc.*, 499 F.3d 520 (6th Cir. 2007); *Jefferson County Sch. Dist. No. R-1 v. Moody's Investor's Servs., Inc.*, 175 F.3d 848 (10th Cir. 1999); *In re Enron Corp. Sec., Derivative & "ERISA" Litig.*, 511 F. Supp. 2d 742, 825 (S.D. Tex. 2005). NRSROs "communicat[e] information [and] expres[s] opinion[s]" about complex financial instruments offered for sale to the public. *N.Y. Times*, 376 U.S. at 266. Almost by definition, NRSRO ratings constitute speech about matters of public concern entitled to protection under *N.Y. Times v. Sullivan*.

Under settled First Amendment principles, insofar as a credit rating states a NRSRO's truly held, pure opinion about the future, it may be immune from liability. *See Milkovich v. Lorain Journal Co.*, 497 U.S. 1, 18-20 (1990); *Compuware*, 499 F.3d at 529; *Jefferson County*, 175 F.3d at 853-856. But NRSROs are not altogether immune from suit, for the First Amendment does not preclude the imposition of liability for a factual misstatement in a rating publication (including the fact that the NRSRO believes a certain rating opinion) if it is made "with 'actual malice' – that is, with knowledge that it was false or with reckless disregard of whether it was false or not." *N.Y. Times*, 376 U.S. at 280. This actual malice standard concerns the speaker's actual knowledge. *Harte-Hanks Commc'ns, Inc. v. Connaughton*, 491 U.S. 657, 688 (1989). The question is whether the speaker "in fact entertained serious doubts as to the truth of its publication." *St. Amant v. Thompson*, 390 U.S. 727, 731 (1968).

The oft-repeated and consistently enforced "actual malice" standard plays the essential role of ensuring that the overhanging threat of liability does not unduly chill or distort speech on matters of public concern. *N.Y. Times*, 376 U.S. at 279-80. In short, absent actual malice, a NRSRO is guaranteed the "breathing room" to speak candidly, without threat of potentially astronomical liability to the investing world for a merely careless mistake or erroneous judgment. *See, e.g.*, *Abu Dhabi Commercial Bank v. Morgan Stanley & Co.*, -- F. Supp. 2d --, 2009 WL 2828018, at *9 (S.D.N.Y. Sept. 2, 2009) (explaining that "the First Amendment protects rating agencies, subject to an 'actual malice' exception, from liability arising out of their issuance of ratings and reports because their ratings are considered matters of public concern").

It must be stressed that the commercial market for NRSROs' publications does not render their credit ratings "commercial speech" entitled only to diluted constitutional protection. For First Amendment purposes, speech is not "commercial" merely because it concerns an economic subject or is disseminated through sale rather than distributed for free. *City of Lakewood v. Plain Dealer Publ'g Co.*, 486 U.S. 750, 756 n.5 (1988). Rather, the Supreme Court has defined the category of "commercial speech" as expression that appears in an advertising or promotional format and proposes a commercial transaction. *See 44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484, 496-500 (1996) (plurality opinion); *Bolger v. Youngs Drug Prods. Corp.*, 463 U.S. 60, 66-67 (1983); *Virginia State Bd. of Pharm. v. Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748, 762 (1976). As the Supreme Court held in *N.Y. Times v. Sullivan*, the right to speak freely "extends to a great variety of subjects and includes matters of public concern." 376 U.S. at 281-82. The Court has since explicitly recognized that "the expression of opinion about a commercial product" is such a matter. *Lowe v. SEC*, 472 U.S. 181, 210 n.58 (1985). Thus, for example, a consumer review of a loudspeaker is afforded the full protection of the First

Amendment. *Ibid.* (citing *Bose Corp. v. Consumers Union of U.S., Inc.*, 466 U.S. 485, 513 (1984)).

Under that precedent, the registration statement and prospectus issued by a registrant may fairly be regarded as commercial speech. But "it is difficult to see why the expression of such an opinion about a marketable security" – *i.e.*, a credit rating – would not fall "squarely" within the ambit of the First Amendment. *Lowe*, 472 U.S. at 210 n.58. A credit rating concerns an economic subject, of course. But it is not an advertisement that seeks to encourage investors to purchase an instrument; it merely provides information to investors to enable them to evaluate whether or not to engage in a transaction. Literally countless articles in publications such as the *Wall Street Journal* and *Bloomberg* serve an indistinguishable function by providing still other information to potential investors. Indeed, MIS and other NRSROs consistently state in their ratings that their opinions have a limited role and are *not* recommendations to purchase, sell, or hold securities. In this respect, a credit rating is "closely analogous to a restaurant or performance review, or a *Consumer Reports* article, in the context of the [investment] markets." *Commodity Trend Serv., Inc. v. CFTC*, 149 F.3d 679, 686 (7th Cir. 1998) (holding that a publisher of information about the performance and value of specific commodity investments was entitled to full First Amendment protection). "Just like a restaurant review does not propose a transaction between the individual reader and the restaurant," credit ratings "do not propose any [investment] transaction," and they thus fall outside the realm of commercial speech. *Ibid.*; *see, e.g.*, *Lowe*, 472 U.S. at 210; *SEC v. Wall St. Publ'g Inst., Inc.*, 851 F.2d 365, 372 (D.C. Cir. 1988). In short, while NRSROs derive revenue by producing and publishing ratings – just as *Car and Driver* derives revenue by producing and publishing magazines that evaluate commercial products – this fact "is as immaterial [for First Amendment purposes] as is the fact that newspapers and books are sold." *N.Y. Times*, 376 U.S. at 266.

As *Compuware*, *In re Enron*, and other decisions concerning rating agencies, *supra*, necessarily recognize, the fact that a credit rating might be produced at the request and expense of the rated security's issuer similarly does not dilute the First Amendment's application to the rating. The critical fact is that the rating – however financed as an economic matter – is substantively an independent evaluation of the debt instrument's credit risk. The characteristics of an independent restaurant review that distinguish it from commercial speech are present whether the reviewer visits covertly and pays for her own meal or is invited in and dines for free. Similarly, reviews of consumer products do not lose First Amendment protection if the publisher is obviously dependent on the advertising sold to the products' manufacturers. In determining the First Amendment's application, courts instead "must look . . . to the content of [the] publications themselves." *Commodity Trend Serv.*, 149 F.3d at 685. For First Amendment purposes, it is dispositive that credit ratings are "impersonal evaluations" of credit risk that "do not propose any [investment] transaction," whatever business model makes their publication economically feasible. *Id.* at 686.

B. The Changes Under Consideration by the Commission Would Subject NRSROs to Liability on a Lower Standard of Proof Than the "Actual Malice" Standard, and Therefore Violate the First Amendment.

The Commission's Concept Release raises the prospect of rescinding Rule 436(g), which exempts the credit ratings of NRSROs from liability under Section 11 of the 1933 Securities Act. Section 11 imposes strict liability for misstatements, subject only to the speaker's right to defend itself by proving that it exercised due care. The Rule thus provides that "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, . . . shall not be considered a part of the registration statement prepared or certified by a person within the meaning of sections 7 and 11 of the Act." 17 C.F.R. § 230.436(g) (2009). Sections 7 and 11, in turn, provide that an expert that "consent[s]" to the inclusion of its analysis in a registration statement is subject to suit if the expert's report "contained an untrue statement of a material fact or omitted to state a material fact," unless the expert affirmatively establishes that "he had, after reasonable investigation, reasonable ground to believe and did believe . . . that the statements were true and that there was no omission to state a material fact required to be stated therein." 15 U.S.C. § 77k.

Critically, as the Commission has recognized, Rule 436(g) by no means immunizes NRSROs from all liability. Pursuant to the core anti-fraud provisions of the securities laws – particularly Section 10(b) of the 1934 Act – NRSROs remain liable for false factual statements knowingly or recklessly made in their ratings. 15 U.S.C. §§ 78j(b), 78u-4(b)(2); *see, e.g.*, *Sanders v. John Nuveen & Co.*, 554 F.2d 790, 793 (7th Cir. 1977) (explaining that the generally accepted scienter standard is designed to deter and penalize conduct "so highly unreasonable and such an extreme departure from the standards of ordinary care as to present a danger of misleading the plaintiff to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it"). That statutory standard resembles the "actual malice" standard applicable under the First Amendment to discussion of matters of public concern, including credit ratings.

By extending Section 11 liability to NRSROs, the Commission's Concept Release would subject their ratings to strict liability (with only an available defense in which the NRSRO must show it was not negligent) for hindsight-inspired claims brought both by disappointed issuers who argue that NRSROs erred by being *too pessimistic* and thereby hurt sales, as well as by disappointed investors who mistakenly treat positive ratings as "buy" recommendations and argue that NRSROs erred by being *too optimistic* and thereby caused losses (or reduced gains). Notably, in addition to dramatically lowering the standard of liability, the Rule's rescission would also shift the burden of proof, requiring NRSROs to answer lawsuits with affirmative proof that they acted with due care. In stark contrast, where matters of public concern are at issue, the First Amendment not only demands proof of "actual malice," in the specific sense of deliberate or reckless (rather than merely negligent) falsehood, but also demands that the *plaintiff* bear the burden of proving actual malice by clear and convincing evidence. *E.g.*, *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 244 (1986) ("[T]he First Amendment requires the plaintiff to show that . . . the defendant acted with actual malice . . . with 'convincing clarity'" (citation omitted)). The requirement that a plaintiff adduce "clear and convincing proof that the . . . falsehood was made with knowledge of its falsity or with reckless disregard for the truth," the Court has explained in the context of defamation, "administers an extremely powerful antidote to the [chilling effect] of the common-law rule of strict liability." *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 342 (1974).

This structural constraint on the proof of a case seeking to impose liability on the basis of discussion of matters of public concern is a critical component of the overarching *N.Y. Times v. Sullivan* principle. Like the standard of care required, the allocation of the burden of proof will greatly impact the chilling effect that arises from the prospect of liability. *See, e.g.*, *Philadelphia Newspapers, Inc. v. Hepps*, 475 U.S. 767, 776 (1986) (explaining that in "instances when the factfinding process will be unable to resolve conclusively whether the speech is true or false[,] . . . the burden of proof is dispositive"). The specter of strict liability subject to an affirmative defense would far more pervasively and more dramatically chill speech than does the standard of liability under present law, which depends on a plaintiff's ability to prove by clear and convincing evidence that a NRSRO engaged in a reckless or deliberate deception. *Id.* at 774 ("the constitutional requirement of fault supersedes the common law's presumptions as to fault and damages"). The regime now contemplated by the Commission is accordingly invalid under the First Amendment.

The perverse ramifications of the harsh rule of strict liability (with only a narrow affirmative defense) that would arise upon the Commission's adoption of the proposals now under consideration are precisely those that the First Amendment was designed to preclude. There is a substantial risk that NRSROs simply could not prepare ratings when threatened with crushing liability to issuers and to the entire investing community in lawsuits in which the plaintiffs bore no burden of proving fault and in which the rating agency bore the burden of proving that it was not negligent but instead exercised due care. The staggering sums invested in rated financial instruments (and thus the potential liability of a NRSRO) generally dwarf the revenue the NRSRO derives through its development and publication of a rating. If converted effectively into insurers of investors against losses incurred in light of good-faith but ultimately inaccurate ratings, and constantly faced with the prospect that any rating could produce a lawsuit that requires a multi-million dollar defense even if the claim is ultimately found meritless, NRSROs rationally would often make the choice simply not to speak, to the great detriment of the public markets.

The Commission must keep firmly in mind that, as with weather predictions or most other evaluative prognostications, NRSRO ratings are susceptible of misunderstanding and misuse, which can give rise to misguided responses. Those who mistakenly view them as tantamount to guarantees about the future performance of a particular investment are bound to encounter disappointment. In turn, legal rules that require rating agencies to compensate the merely disappointed are bound to lead to still further disruption of the financial markets by encouraging issuers and investors alike to place undue reliance on NRSROs' inherently uncertain prognoses, and by chilling candid and honest assessment by rating agencies that must respond to the prospect of suits under Section 11 by attempting to shield themselves from liability.

At best, NRSROs would face perverse incentives either to artificially inflate the assessment of risks, fearing investor suits when rated investments lose value, or to artificially discount those risks, fearing suits by issuers pointing fingers of blame at those who did not issue ratings favorable enough to permit them to succeed in the market. It would be wishful thinking to imagine that the pulls and tugs of these competing distortive incentives would precisely cancel each other out in a coincidentally perfect balance. The upshot would be ratings distorted to an unpredictable degree and in an unpredictable direction. But the entirely predictable result would be to render capital markets less informed and less efficient.

Worse still, because Sections 7 and 11 provide a private right of action for monetary damages – that is, they authorize lawsuits brought by private plaintiffs seeking money rather than regulation by the Commission's expert regulators – the private party suits filed upon the withdrawal of Rule 436(g) would lack the institutional checks that can mitigate the chilling effects of a government's regulation of speech relating to financial markets. Though the First Amendment is of course a protection against governmental interference with private communication, certain free speech protections are inherent in the nature of government enforcement when contrasted with the prospect of unchecked private litigation. Government officials steward limited public resources and are generally held accountable by legislatures and constituents alike. We accordingly trust that government exercises its enforcement authority with due regard for the public interest at large and with reference to overarching policy objectives. *See, e.g.*, *Holloway v. Bristol-Meyers Corp.*, 485 F.2d 986, 997 (D.C. Cir. 1973) (stressing that the FTC enforcement decisions at issue were informed by "the relative seriousness of the [alleged] departure from accepted trade practices, its probable effect on the public welfare, the disruption to settled commercial relationships that enforcement proceedings would entail, whether action [was] to be taken against a single party or on an industry-wide basis, the form such action should take, the most appropriate remedy, the precedential value of the rule of law sought to be established, and a host of other considerations" and were "weigh[ed] . . . against the Commission's broad range policy goals . . . to determine [their] place in the overall enforcement program"). This trust extends not only to the decision whether to initiate an action in the first instance, but also to the choice of remedy; governments often pursue remedies that balance the public interest against legitimate rights of free expression. *E.g., ibid.*; *National Comm'n On Egg Nutrition v. FTC*, 570 F.2d 157 (7th Cir. 1977), *cert. denied*, 439 U.S. 821 (1978) (FTC prospectively prohibited advertisements with specific claims pertaining to the scientific evidence that eggs increased the risk of heart and circulatory disease, but did not pursue pecuniary remedies).

In contrast, "[p]rivate litigants are not subject to the same constraints" and "may institute piecemeal lawsuits, reflecting disparate concerns and not a coordinated enforcement program" and almost always seeking substantial monetary damages. *Holloway*, 485 F.2d at 997-98; *see also N.Y. Times*, 376 U.S. at 277-78. Indeed, private litigation raises the specter of commonplace vexatious and abusive lawsuits, a risk that in the context of expression creates a great prospect of chilling free speech. *Cf. Vermont Agency of Nat. Res. v. United States ex rel. Stevens*, 529 U.S.

765, 775-776 (2000) (noting the historic abuse of "informer statutes"). Were the Commission considering the measured, deliberate regulation of the content of credit ratings, there would nonetheless be cause for First Amendment concern. Because it is instead considering effectively delegating a significant element of the regulation of NRSROs to private parties (and their lawyers) who have a single-minded goal of pursuing any available compensation no matter what the adverse effect such claims might have on the dissemination of information that benefits that public, that concern is greatly magnified.

The Rules now under consideration by the Commission not only violate the expressive rights of NRSROs, but also threaten the investing public's correlative right to learn what NSROs have to say. *See First National Bank of Boston v. Bellotti*, 435 U.S. 765, 777 n.12 (1978) ("The individual's interest in self-expression is a concern of the First Amendment separate from the concern for open and informed discussion, although the two often converge."). The Supreme Court has repeatedly emphasized that the First Amendment plays "[a] role in affording the public access to discussion, debate, and the dissemination of information and ideas." *Id.* at 783 (collecting cases). It does so by "prohibit[ing] government from limiting the stock of information from which members of the public may draw." *Ibid.* As noted, NRSROs provide important information that serves the investment market. The participants in that market enjoy a First Amendment right to receive ratings free from governmental interference that stand independently from NRSROs' right to speak, but that would be no less violated were the Commission to rescind Rule 436(g).

The principle at stake extends far beyond the public debt markets. Rescission of Rule 436(g) would establish a perverse precedent with general applicability: a medical journal preparing to publish a positive analysis of a drug could be made to do so under the overhanging threat that the drug will later be alleged to cause health risks, producing crippling liability unless the journal's publisher could convince a finder of fact that it had exercised due care; a company that conducts crash tests and publishes studies on the safety features of new car models could be held liable for negligence when an unanticipated hazard emerges unless it could affirmatively satisfy a factfinder that it had not been careless; and a newspaper could be sued for the cost of opera tickets purchased by disappointed readers who missed the show because the paper's review negligently misidentified the venue.

Finally, rescission of Rule 436(g) is a remedy ill-matched to the problem hypothesized by the Commission – *viz.*, "that there is no longer a sufficient basis to exempt NRSROs and to distinguish between NRSROs and credit rating agencies that are not NRSROs." Concept Release on Possible Rescission of Rule 436(g) Under the Securities Act of 1933, 74 Fed. Reg. 53,114, 53,114 (Oct. 15, 2009). The First Amendment remains not only a sufficient basis for Rule 436(g), but also a bar to the liability that would result from the Rule's rescission. If greater parity is to be pursued between NRSROs and other credit rating agencies, such parity is more sensibly achieved by applying the Rule to all credit rating agencies. That the right to speak of some is protected while that of others is threatened is a reason to *extend* First Amendment protection, not a reason to *eliminate* it.

In connection with the Disclosure Proposal, the Commission has described a perceived market problem that may more directly explain its consideration of the possible rescission of Rule 436(g). In the aftermath of the recent international credit crisis, the Commission fears that "investors may not have access to sufficient information about credit ratings." Credit Ratings Disclosure, 74 Fed. Reg. 53,086, 53086 (proposed Oct. 15, 2009) (to be codified at 17 C.F.R. pts. 220, 229, 239, 240, 249, and 274). The Commission is understandably eager to ensure that investors "understand credit ratings and their limitations." *Ibid.* Investors already have ready access to a significant amount of information about specific credit ratings, rating methodologies, the rating process, and potential conflicts of interest. But to the extent that investors have not focused on, or been adequately directed to, the available information, the dramatic expansion of NRSROs' potential liability is no solution. The need for investors to be informed about where to access information, and how to properly contextualize that information, far from justifying steps that would chill the uninhibited formulation and dissemination of credit ratings, is a reason to avoid just such steps. Instead, the public would be served best if the government and private parties facilitated public education about the ratings process and the appropriate role played by issuer-financed but structurally independent ratings. "If there be time to expose through discussion the falsehood and fallacies, to avert the evil by the processes of education, the remedy to be applied is more speech[.]" *Whitney v. California*, 274 U.S. 357, 377 (1927) (Brandeis, J., concurring).

C. The Rules Under Consideration Are Not Immunized from First Amendment Scrutiny by the Prospect that An NRSRO Can Theoretically Elect to Withhold Its Consent to the Use of Its Ratings And Instead Publish Those Ratings for Free.

Given that liability attaches under Section 11 to the reports of experts who "consent" to the use of their reports in registration statements, we anticipate that some may argue that the Commission may withdraw Rule 436(g) consistent with the First Amendment because a NRSRO could avoid liability by withholding consent. *See* 15 U.S.C. § 77g ([for] "any [person] named as having prepared or certified a report or valuation for use in connection with the registration statement, . . . the written *consent* of such person shall be filed with the registration statement." (emphasis added)); 15 U.S.C. § 77k (an expert can be held liable only if he "has *with his consent* been named as having prepared or certified" the disputed valuation or report (emphasis added)).

Whether or not that argument would have merit if the Commission were to go no further than withdrawing Rule 436(g), it certainly lacks force when one accounts for the Commission's Disclosure Proposal. If adopted, the Disclosure Proposal would "require disclosure by registrants regarding credit ratings in their registration statements . . . if the registrant uses the rating in connection with a registered offering." 74 Fed. Reg. at 53,087. The phrase "uses" is defined extremely broadly to encompass not merely the issuer's reliance on the rating "in a prospectus or a term sheet," but *any* reference to the rating in "oral and written selling efforts," including in response to inquiries about the offering. *Id.* at 53,090.

The practical consequence (and seeming purpose) of the combined adoption of *both* the Concept Release on Rule 436(g) *and* the Disclosure Proposal would be to force NRSROs to acquiesce in the inclusion of their ratings in registration statements, and thus to subject themselves to liability under Section 11. A credit rating has value to a registrant precisely because it may be "used" in the course of the issuance. In turn, the Disclosure Proposal – by requiring the issuer to include the credit rating in the registration statement if it makes any "use" of the rating – would seemingly require the issuer to insist on the NRSRO's consent as a prerequisite to soliciting the rating. That is so because the registrant *cannot* include the rating in the registration statement (as the Disclosure Proposal requires) absent the rating agency's consent. Section 7 of the 1933 Act provides that, if "any person whose profession gives authority to a statement made by him[] is named as having . . . prepared or certified a report . . . for use in connection with the registration statement, the written consent of such person shall be filed with the registration statement." 15 U.S.C. § 77g. In short, under the Disclosure Proposal, a registrant could not use a rating in connection with a registered offering without the NRSRO's permission, triggering Section 11. And, putting it mildly, a registrant is unlikely to secure a rating it cannot use.

Our view that the Commission has designed these Rule changes at least in part with the purpose of subjecting NRSROs to liability under Section 11 without regard to their statutory right to grant or withhold "consent" is reinforced by the nature of the disclosure that the proposals would mandate. The Commission could, after all, accomplish its stated goal of ensuring the wider dissemination of information to investors by requiring the universal disclosure of credit ratings in a variety of wide-open contexts, such as on the Internet. NRSROs are already required to make public their ratings methodologies, descriptions of their ratings, and other information, *see* 17 C.F.R. §§ 240.17g-1, 249b.300 (2009), and the vast majority of NRSRO ratings are disseminated to the public for free. Instead, the Commission's Proposal specifically calls for NRSRO ratings to be disclosed *as part of the registration statement*, which has the particular consequence of triggering the consent and liability provisions of Sections 7 and 11.

The combined, practical effect of these Rules would thus be to subject NRSROs to liability under Section 11 of the 1933 Act for their ratings, without regard to whether a NRSRO would otherwise withhold its consent to the use of its rating in a registration statement. If the Commission were merely to repeal Rule 436(g) without adopting the Disclosure Proposal, a NRSRO could issue a rating and withhold its consent to the inclusion of that rating in the registration statement. Alternatively, if the Commission were to adopt the Disclosure Proposal while leaving Rule 436(g) in place, the issuer's disclosure of the rating would not subject the NRSRO to Section 11 liability. But if *both* these policy initiatives are adopted, a NRSRO could "choose" to withhold consent and thereby avoid the prospect of crushing Section 11 liability only in the sense that it could "choose" to go out of business.

The dilemma that the Disclosure Proposal and Concept Release would together create for NRSROs does not survive constitutional scrutiny. The First Amendment objections to the application of Section 11 liability to NRSROs are not answered by the hypothetical prospect that a rating agency could avoid liability by not selling its ratings to issuers. The Supreme Court has recognized the unremarkable proposition that interference with a speaker's ability to secure "compensation unquestionably imposes a significant burden on expressive activity." *United States v. National Treasury Employees Union*, 513 U.S. 454, 468 (1995) (citing *Simon & Schuster, Inc. v. Members of N.Y. State Crime Victims Bd.*, 502 U.S. 105 (1991)). "[C]ompensation provides a significant incentive toward more expression." *Id.* at 469. Just as the First Amendment guards against regulation that directly chills speech, it protects incentives like compensation that promote speech. Thus, for example, the Amendment forbids "a law that broadly prohibits federal employees from accepting any compensation for making speeches or writing articles" because such a law "induces them to curtail their expression." *Id.* at 457, 469. Importantly, this protection is even stronger when private speech, as opposed to that of public employees, is implicated. *E.g.*, *Waters v. Churchill*, 511 U.S. 661, 673 (1994).

To illustrate the point, the government could not, consistent with the First Amendment, subject a newspaper to suit for negligence based on the contents of articles published in editions of the paper *sold* to the public, even if the paper were exempt from liability for editions *given away for free* and funded entirely by advertising revenue. The courts would not close their eyes to the reality that a publisher must receive revenues in order to remain in business, rendering the nominal exemption entirely hollow. So too here, the Commission's Disclosure Proposal has the effect of negating a NRSRO's right under Section 7 to withhold its consent to the use of its ratings in a registration statement.

The suggestion that NRSROs could in fact survive economically by adopting a different business model fails both in fact and as a matter of First Amendment principle. If the twin policy changes now under consideration were adopted, a NRSRO simply could not operate as a profitmaking entity without subjecting itself to Section 11 liability. Most obviously, as discussed, an issuer will not solicit a rating absent the NRSRO's permission to disclose the rating in the registered offering. Nor would issuers support rating services through subscription fees; they would still need to disclose the rating in the registration statement, triggering Section 11 liability.

Nor is there any realistic prospect that an NRSRO such as MIS, which maintains broad rating coverage of more than 100 sovereign nations, 11,000 corporate issuers, 26,000 public finance issuers, and 110,000 structured finance obligations, could survive economically under a model in which it charged investors for ratings. The reasons why an investor-pays model became unworkable 40 years ago are even more compelling today. Changes in media technology, from photocopying to the Internet, have made it easier for non-paying investors to "free-ride" on what is intended to be "subscriber only" rating information. Moreover, the paying investor base is far too small to support the depth and breadth of technical analysis undertaken by NRSROs that collectively analyze and publish millions of ratings – ratings that are now disseminated, for free, to the public at large. For that reason, it is unsurprising that, as the Commission has noted, the seven NRSROs currently operating under the issuer-pays model account for approximately 99% of the total, currently outstanding credit ratings of NRSROS.

Securities & Exchange Commission, Annual Report on Nationally Recognized Statistical Rating Organizations (September 2009) at 9-10.

In sum, the net effect of the Commission's proposals would be to undermine dramatically NRSROs' ability to derive revenue; at worst, the proposals threaten the very destruction of NRSROs. A core purpose of the First Amendment is to preclude laws under which "some speakers will be destroyed," *Hurley v. Irish-American Gay, Lesbian and Bisexual Group of Boston*, 515 U.S. 557, 577 (1995), as would occur if NRSROs were precluded from procuring compensation for their ratings.

Even if, contrary to fact, it were possible for NRSROs to derive sufficient revenue by switching to a subscription model – whether the subscribers were issuers or investors – by effectively *forcing* NRSROs to do so as a condition of their economic survival, the Rules under consideration would run afoul of the First Amendment. Principally, they would impermissibly infringe NRSROs' right to choose how to deliver their message. The First Amendment protects not only a speaker's right to deliver a message, but also his right to choose how to do so. *E.g.*, *Schneider v. New Jersey*, 308 U.S. 147, 163 (1939) ("[O]ne is not to have the exercise of his liberty of expression in appropriate places abridged on the plea that it may be exercised in some other place."). For example, the government cannot prevent a speaker from promoting his message on the ground that "the speaker's listeners could come by his message by some other means, such as seeking him out and asking him what it is." *Virginia Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748, 757 n.15 (1976). Importantly, the Supreme Court has specifically recognized that a speaker's incentive to speak may rest on his ability to control the commercial distribution of his message. *E.g.*, *Zacchini v. Scripps-Howard Broadcasting Co.*, 433 U.S. 562, 573 (1977) (explaining that we "protect[t] the proprietary interest of the [entertainer] in his act in part to encourage such entertainment"). Because "much of [the] economic value" of credit ratings "lies in the right of exclusive control over" their sale, that control "provides an economic incentive for [NRSROs] to make the investment required to produce [ratings] of interest to the public." *Id.* at 575, 576 (internal citation omitted). As we have explained, that incentive is of constitutional significance. *National Treasury Employees Union*, 513 U.S. at 469.

Indeed, if NRSROs' ability to derive revenue from their ratings is to be constitutionally protected in any meaningful sense, it is the NRSROs rather than the government that must be allowed to decide how best to derive that revenue. Congress could not require all free newspapers (supported by advertising revenue) to submit to the editorial control of a federal agency; a free newspaper's theoretical ability to avoid federal censorship and to stay in business by instead charging its readers would not save such a law. Similarly, the First Amendment would not allow Congress to offer Google the choice between submitting to a federally-mandated internet search algorithm or charging its users.

Further, forcing NRSROs to charge investors for ratings would infringe investors' independent right to receive the ratings that NRSROs desire to publish free of cost to the recipient. Shifting to investors the cost of ratings would by definition eliminate the public's free access to those ratings – access currently made possible through underwriting by issuers. The Supreme Court has recognized that Congress may promote the public's interest in receiving information on matters of public concern by affirmatively promoting widespread, free access to that information: "[t]here is a substantial governmental interest in promoting" free access to information, "especially for [those] who are unable to afford other means of receiving [it]." *Turner Broadcasting System, Inc. v. FCC*, 512 U.S. 622, 646 (1994) (internal quotation omitted);

see also Virginia Bd. of Pharmacy, 425 U.S. at 765 ("So long as we preserve a predominantly free enterprise economy, the allocation of our resources in large measure will be made through numerous private economic decisions. It is a matter of public interest that those decisions, in the aggregate, be intelligent and well informed."). Indeed, the weight of this public interest may even justify the limited regulation of speech; the public benefit of free access can trump otherwise constitutionally dubious burdens on a speaker's right to control his message. For example, the Supreme Court "[has] held that 'protecting noncable households from loss of regular television broadcasting service due to competition from cable systems,' is not only a permissible governmental justification, but an 'important and substantial federal interest'" that may justify the government-mandated inclusion of broadcast channels in cable programming. *Id.* at 647 (quoting *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 714 (1984)); *see also United States v. Midwest Video Corp.*, 406 U.S. 649, 661-662, 664 (1972) (plurality opinion). It would turn this core First Amendment principle on its head to justify the imposition of strict liability (or even negligence-based liability) for NRSRO ratings – which are currently available without cost to the public at large – with the observation that NRSROs could in theory avoid such liability by selling their ratings to the narrow class of investors who might afford their substantial cost. Worse, that answer would ignore the First Amendment rights of those investors unable to afford the ratings they are now provided for free. *E.g.*, *Virginia Bd. of Pharmacy*, 425 U.S. at 757 n.15 (rejecting argument "that there is no . . . right to receive the information that another seeks to disseminate . . . when the person objecting could obtain the information in another way"). *See also, e.g.*, *Martin v. City of Struthers*, 319 U.S. 141, 146-47 (1943) (describing as "clearly vital to the preservation of a free society" the "[f]reedom to distribute information to every citizen wherever he desires to receive it"); *id.* at 146 (describing free distribution as "essential" where people cannot afford alternatives).

* * * *

In sum, the proposed Rules now under consideration threaten core First Amendment rights both of NRSROs and of the investing public. The threat is substantial, and it has disturbing implications well beyond the world of financial markets.

V. The Changes Under Consideration Would Violate the 1933 Securities Act and the Separation of Powers.

For related reasons, the proposals now under consideration are invalid because they conflict directly with the governing Act of Congress and accordingly represent an executive usurpation of lawmaking power. Even if Congress could, consistent with the First Amendment, have expressly empowered the Commission to promulgate its proposed dyad – mandating credit rating disclosures and extending strict liability (subject to an affirmative defense of non-negligence) to the NRSROs that prepare those ratings – the SEC's own unilateral adoption of that dyad would constitute agency action not only outside the authority delegated to that agency by Congress but in flat contravention of the pertinent congressional legislation, the 1933 Securities Act.

As discussed above, both Section 7 and Section 11 reserve to "experts" the right to decide whether or not to "*consent*" to the use of their reports in a registration statement, and thereby to control whether they shall subject themselves to the otherwise impermissibly chilling liability imposed under Section 11. The authorities are in accord that "consent" requires a *voluntary* act on the part of the consenting party. *E.g.*, THE OXFORD ENGLISH DICTIONARY 760-61 (2d ed. 1989) (defining consent as the "voluntary agreement to or acquiescence in what another proposes or desires."); BLACKS LAW DICTIONARY 346 (9th ed. 2009) ("consent" is "[a]greement, approval, or permission as to some act or purpose, esp. *given voluntarily* by a competent person." (emphasis added)). *Cf. Schneckloth v. Bustamonte*, 412 U.S. 218 (1973) (under the Fourth Amendment, consent to a search must be "knowing and voluntary").

For the reasons discussed above, the combined effect of the proposals under consideration is to obviate a NRSRO's statutory right to give or withhold its "consent." By mandating the disclosure of credit ratings, the rules ensure that registrants will value – and thus solicit and pay for – only those ratings that they are certain can be disclosed. This means that registrants will demand *in advance of securing a rating* that the respective rating agency agree to the rating's subsequent disclosure. The rating agencies that function economically through a process in which registrants solicit and pay for independent ratings would be forced to choose between acquiescing in the use of their ratings or ceasing to operate as economically viable enterprises. Such a Hobson's choice is plainly incompatible with Congress's "unambiguously expressed intent" that liability attach only to those experts who voluntarily accept it. *Chevron*, 467 U.S. at 843; *see INS v. Cardoza-Fonseca*, 480 U.S. 421, 431-32 (1987); *Pinter v. Dahl*, 486 U.S. 622, 653-54 (1988) (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976)) (Where a proposed construction "would add a gloss to the operative [statutory language] quite different from its commonly accepted meaning," the necessary conclusion is that "Congress did not intend such a gross departure from the statutory language.").

When "the intent of Congress is clear, that is the end of the matter; for . . . the agency[] must give effect to the unambiguously expressed intent of Congress." *Chevron*, 467 U.S. at 842-43. Here, "the scope of liability created by a particular section of the Securities Act must rest primarily on the language of that section." *Pinter,* 486 U.S. at 686. Because Congress is presumed to be relying on the plain and ordinary meaning of the words it selects, the

Commission cannot act in a manner that negates a rating agency's ability to "consent." *E.g. Hughey v. United States*, 495 U.S. 411, 416 (1990); *Cardoza-Fonseca*, 480 U.S. at 431-32 (collecting cases).

Even if there were some linguistic ambiguity in the "consent" requirement of Sections 7 and 11 – and we perceive none – the Rules under consideration would be invalid because they are not "based on a permissible construction of the statute." *Chevron*, 467 U.S. at 843. Even where Congress has not explicitly prohibited a proposed interpretation, an agency may not act in a manner that is "arbitrary, capricious, or manifestly contrary to the [relevant] statute." *Id.* at 844; *accord United States v. O'Hagan*, 521 U.S. 642, 673 (1997). Because the 1933 Securities Act must be viewed as a "symmetrical and coherent regulatory scheme," *Gustafson v. Alloyd Co.*, 513 U.S. 561, 569 (1995), these Rules are unlawful because their practical consequence completely frustrates the purpose underlying the consent provisions adopted by Congress. For, while the consent provisions serve as a backstop to ensure that liability is assumed voluntarily, the Commission's proposed rules take the disturbing step of making this "consent" effectively, and profoundly, involuntary.

The purpose of the 1933 Securities Act was "to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing." *Ernst & Ernst*, 425 U.S. at 195. Indeed, "Section 11 was enacted so that those persons with a *direct role* in a registered offering would be subject to a rigorous standard of liability to assure that disclosure regarding securities was accurate." 74 Fed. Reg. at 53,115 (emphasis added). However, in addition to imposing this "rigorous standard of liability," Congress took the exceptional step of providing an added layer of protection to protect experts from the perils of litigation. To this end, the requirement of "consent" reserves *to experts* the right to determine whether to act as virtual insurers of the accuracy of their reports.

By contrast, the Commission is now considering acting unilaterally to attach liability to experts as it sees fit. Yet it is precisely this authority that the 1933 Securities Act withholds. The statute places that voluntary choice in the hands of experts as a means to protect those who opt not to play a "direct role" in security sales, with the enhanced penalties that the 1933 Act attaches to that role. In doing so, Congress struck a balance between insuring consumers against fraud and protecting those actors indirectly involved in securities analysis from serving the costly role of insurers. By effectively *requiring* that NRSROs nominally "consent" as a prerequisite to *any* commercially published analysis of credit ratings, however, the Commission's rules directly undermine this balance by holding strictly liable (subject only to an affirmative defense of due diligence) a class of persons who choose to play *no* "direct role" in an issuance's distribution, reflecting their distinct role as impartial analysts and publishers regarding credit risk. No matter the agency's intent, "an administrative agency may not exercise its authority 'in a manner inconsistent with the administrative structure that Congress enacted into law.'" *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 125 (2000) (quoting *ETSI Pipeline Project v. Missouri*, 484 U.S. 495, 517 (1988)); *accord Ragsdale v. Wolverine Wide World, Inc.*, 535 U.S. 81, 91 (2002).

Finally, the Commission's proposed rules threaten to defeat the very underpinnings of the consent provision. Although the 1933 Securities Act was proposed in the aftermath of the Great Depression, President Roosevelt wisely urged restraint in the face of this turmoil. In his message to Congress, the President expressed his will that the Securities Act "protect the public with the least possible interference to honest business." H.R. REPORT NO. 73-85, at 1 (1933). This balance, he realized, would best reduce the incentive for those benefiting from the registration of securities to withhold information, while simultaneously leaving neutral parties free to proffer independent analyses – a freedom that intervening decades of First Amendment jurisprudence would lead us today to couch in constitutional terms. Yet even if there were reasons to doubt the Congress's wisdom, it would be up to Congress, acting under Article I, and not to the Article II or III branches of the federal government, to make that fundamental policy choice. Principles embedded in the Constitution's separation of powers forbid the Commission unilaterally to assume such a revisionary role.

It is a foundational principle of the separation of powers that "[t]he rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law. Rather, it is 'the power to adopt regulations to carry into effect the will of Congress as expressed by the statute.'" *Ernst & Ernst*, 425 U.S. at 213-14 (quoting *Dixon v. United States*, 381 U.S. 68, 74 (1965)); *accord Santa Fe Indus. Inc. v. Green*, 430 U.S. 462, 472-73 (1977). Here, where the language of the statute is clear and where its content and history reveal a clear purpose *not* to compel experts to accept liability, the Commission is forbidden to enact rules to the contrary. *Cf. Santa Fe*, 430 U.S. at 474. When one also takes into account the First Amendment obstacle to the Rules under consideration by the Commission, the conclusion becomes doubly inescapable.

VI. Conclusion

For the reasons stated above, the Commission's Disclosure Proposal and Concept Release, if both adopted, would together violate the First Amendment and contravene the 1933 Securities Act.

Respectfully submitted,

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