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Apology Lite: Truths, Doubts, and Reconciliations in the Senate's Guarded Apology for Slavery

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I. INTRODUCTION

The United States Senate formally apologized for slavery on June 18, 2009.[1] This followed an apology made nearly a year earlier, on July 29, 2008, by the House of Representatives.[2] Unlike the House apology, the Senate apology contains additional limiting language, specifically stating that it cannot be used as a ground for monetary compensation.[3] The apology is nearly nine hundred words, with a preamble which goes into some detail about the wrongness of slavery, admitting that slaves were "brutalized, humiliated, [and] dehumanized."[4] It then states:

> (1) APOLOGY FOR THE ENSLAVEMENT AND SEGREGATION OF AFRICAN-AMERICANS.—The Congress . . . apologizes to African-Americans on behalf of the people of the United States, for the wrongs committed against them and their ancestors who suffered under slavery and Jim Crow laws . . . .

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[1] Krissah Thompson, *Senate Backs Apology for Slavery; Resolution Specifies That It Cannot Be Used in Reparations Cases*, WASH. POST, June 19, 2009, at A05.

[2] *Id.*; Darryl Fears, *House Issues an Apology for Slavery*, WASH. POST, July 30, 2008, at A03.

[3] *See* Thompson, *supra* note 1, at A05 ("One key difference is that the Senate version explicitly . . . say[s] that the resolution cannot be used in support for claims for restitution . . . .").

[4] S. Con. Res. 26, 111th Cong. (as passed by Senate, June 18, 2009).

(2) DISCLAIMER.—Nothing in this resolution—

(A) authorizes or supports any claim against the United States; or

(B) serves as a settlement of any claim against the United States.[5]

The Senate's "apology lite," is likely to influence future reparations actions, as state and local apologies and truth commissions become increasingly common.[6] This Essay will discuss the apology's legal and moral effects. It will examine the role of apology generally in the slavery reparations debate, the question of whether a stand-alone apology can ever be a valid form of reparation, and whether the Senate apology in particular satisfies the legal and moral goals of reparations.[7]

II. THE ROLE OF APOLOGY IN REPARATIONS

Many scholars have suggested ways in which apology can play a significant role in reparations. Among the most vocal of these is Professor Roy Brooks, who has articulated a compelling moral theory of reparations relying on apology. Brooks argues that reparations are a step in the process of atonement, the moral healing process that helps a community rebuild in the wake of mass injustice.[8] A government which has committed an atrocity takes on "a moral obligation to apologize and to make that apology believable by doing something tangible called a reparation."[9] This in turn leads to healing: "Atonement (apology plus reparations) and forgiveness are thus the key ingredients of racial reconciliation."[10]

Others have articulated broader roles for apologies. Professor Alfred Brophy writes that "[s]ome injuries may be best repaired by study of the past injustice and by apology" and argues that apology can play a vital role in slavery reparations.[11] For instance, apologies can "serve as a basis for

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[5] *Id.*

[6] *See* Kaimipono David Wenger, Towards Microreparations (2009) (draft, on file with author) (discussing the increase in state and local apologies and reparations programs). Throughout this short Essay, I will use the term "reparations" narrowly to mean compensation to Blacks or to slave descendants for the harms of slavery or Jim Crow. In addition, I will use the capitalized term "Black" rather than "black" or "African-American." *Cf.* Kimberle W. Crenshaw, *Race, Reform, and Retrenchment: Transformation and Legitimation in Antidiscrimination Law*, 101 HARV. L. REV. 1331, 1332 n.2 (1988) (discussing use of the word "Black").

[7] There are a number of other issues relating to the Senate's apology outside the scope of this Essay, including whether institutions are capable of apology, and whether reparation has already been made (such as through affirmative action or the Civil War amendments).

[8] *See* ROY L. BROOKS, ATONEMENT AND FORGIVENESS: A NEW MODEL FOR BLACK REPARATIONS 142–43 (2004).

[9] *Id.* at ix.

[10] *Id.* at x.

[11] ALFRED L. BROPHY, REPARATIONS: PRO & CON 11 (2006).

subsequent arguments about equality and reparations," acting as a foundation for a broader program of reparations.[12] Professor Martha Minow writes that apologies can "promote reconciliation and healing" in cases of mass injustice; they can be a "restorative step[] toward justice."[13] And Congressman John Conyers, the principal reparations advocate in Congress, sees apology and truth commissions as a way of opening the dialogue towards restitution.[14] Not all reparationists are apology advocates;[15] but for many, apology plays an important role.

Apology advocates build toward a goal of reconciliation, or restorative justice. Restorative justice, a concept drawn from the international human rights context, is not focused on punishment or on the redistribution of wealth; rather, restorative justice seeks to repair society through reconciliation, ultimately healing both victims and society itself.[16] "[R]estorative justice seeks to repair the injustice, to make up for it, and to effect corrective changes in the record . . . ."[17]

It is not surprising that some advocates see apology as playing a role in the slavery reparations arena. Apology has played a role in other highly visible cases of restitution for mass harm, in particular the cases of Holocaust victims and Japanese-American internees. In each case, victims

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[12] *Id.* at 13–14.

[13] MARTHA MINOW, BETWEEN VENGEANCE AND FORGIVENESS 114 (1998).

[14] *See* John Conyers, *Reparations: The Legislative Agenda*, 29 T. JEFFERSON L. REV. 151, 153 (2007) (describing apology as an incomplete forerunner of reparations and restitution); *see* ELAZAR BARKAN, THE GUILT OF NATIONS 291 (2000) (noting that Conyers seeks "an official public apology for the brutality of slavery" as "fundamental for restitution"). Other scholars, such as Elazar Barkan, Mari Matsuda, and Eric Yamamoto, have also discussed ways in which apology can play a role in healing after mass injustice, including slavery. *See* BARKAN, *supra*, at 287–92, 323–24; Mari J. Matsuda, *Looking to the Bottom: Critical Legal Studies and Reparations*, 22 HARV. C.R.-C.L. L. REV. 323, 395–96 (1987); Eric K. Yamamoto et al., *American Racial Justice on Trial—Again: African American Reparations, Human Rights, and the War on Terror*, 101 MICH L. REV. 1269, 1335–36 (2003).

[15] Some important reparations advocates have spent little time on the idea of apology. Notably, Randall Robinson's book *The Debt*, probably the most influential recent book on reparations, mentions the idea of apology only peripherally. *See* RANDALL ROBINSON, THE DEBT: WHAT AMERICA OWES TO BLACKS (2000). Robert Westley's influential law review article also focuses elsewhere. *See* Robert Westley, *Many Billions Gone, Is it Time to Reconsider the Case for Black Reparations?*, 40 B.C. L. REV. 429, 433–34 (1998) (discussing reparations as a "critical legalism"); *see also* BROPHY, *supra* note 11, at 67–69 (discussing the importance of Robinson's and Westley's work). A variety of other important sources similarly omit the idea. Radical activist James Forman's *Black Manifesto* contains detailed demands for compensation, education, and political change, but no discussion of apology. *See* James Forman, *The Black Manifesto*, *in* BLACK MANIFESTO: RELIGION, RACISM, AND REPARATIONS 114 (Robert S. Lecky & H. Elliott Wright eds., 1969). Nor does law professor Boris Bittker's legal analysis in *The Case for Black Reparations*. *See* BORIS BITTKER, THE CASE FOR BLACK REPARATIONS 5–7 (1973). In general, many advocates prefer a tort model which "seek[s] nonapologetic redress through litigation." BROOKS, *supra* note 8, at 3.

[16] *See* MINOW, *supra* note 13, at 91; Linda M. Keller, *Seeking Justice at the International Criminal Court: Victims' Reparations*, 29 T. JEFFERSON L. REV. 189, 190–91 (2007) (describing restorative justice).

[17] MINOW, *supra* note 13, at 91. Part of the restitution is recognition that slavery involved a serious breakdown of the rule of law. *See, e.g.*, Kaimipono David Wenger, *Reparations Within the Rule of Law*, 19 T. JEFFERSON L. REV 231, 231–32 (2007).

ultimately received a variety of reparations including apology; and of course, these cases are frequently cited as models for slavery reparations.[18]

For many reparations advocates, apology is clearly viewed as a sort of *conversation starter*[19]—it is a stepping stone which allows the debate to move on to further reparative acts such as monetary compensation. Importantly, advocates generally do not suggest that apology creates a legal obligation for further payment. The existence of numerous official apologies which give no legal right to compensation (most recently, to Native Hawaiians) show that apology does not automatically grant a right to compensation.[20] Advocates do suggest, however, that an apology may create impetus, and build a moral foundation, for further reparations. (Reparations opponents and many members of the public more generally often agree that apology could lead to further steps, but view this possible eventuality as a negative development.)[21]

But what if apology does not lead to further action? What if the apology is instead a *conversation stopper*, intended to foreclose rather than foster further remedies? Can a stand-alone apology ever be an effective reparative act?

III. THE EFFECTIVENESS OF A STAND-ALONE APOLOGY

The legal literature does not often address the value of stand-alone apologies; rather, discussions have tended to analyze the value of apologies within a context of broader reparations goals. Those discussions are invaluable starting points for analyzing the stand-alone apology. A threshold question is why apology should ever matter. Are not *all* apologies simply words? Why should they ever carry any weight?

Apologies are merely words, but that description is incomplete. Apologies are a unique type of symbolic words that carry special weight and moral power. Thus, Martha Minow writes that "[t]he mystery of apology depends upon the social relationships it summons and strengthens;

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[18] For instance, Brophy notes that one "factor leading to the reinvigoration of talk about reparations for slavery and Jim Crow are the models of reparations that other groups—Native Americans, Holocaust victims, Japanese Americans interned during World War II, South Africans—have obtained." Alfred L. Brophy, *Some Conceptual and Legal Problems in Reparations for Slavery*, 58 N.Y.U. ANN. SURV. AM. L. 497, 499 (2003).

[19] I am indebted to my colleague Rebecca Lee for this useful terminology.

[20] *See* BROPHY, *supra* note 11, at 30–33 (listing reparations programs and proposals); *see also* Ashby Jones, *'Much Is Owed'; Slavery Apology Vote Rekindling Talk of Reparations*, Wall Street Journal Law Blog, http://blogs.wsj.com/law/2009/06/19/much-is-owed-slavery-apology-vote-rekindling-talk-of-reparations/ (June 19, 2009, 9:28 EST) (discussing potential concerns over the Hawaiian case).

[21] Barkan notes: "[T]he public associates apology with potential restitution and payments. Indeed, the opposition to apology is often presented as a rejection of restitution." BARKAN, *supra* note 14, at 288. *See* Derek Kravitz, *State Debates Slavery Apology*, ST. LOUIS POST-DISPATCH, Apr. 13, 2007, at C7 (discussing concerns about whether a proposed Missouri apology would lead to liability).

the apology is not merely words."[22] And as Al Brophy wryly notes, "[o]ne can gauge the power of truth commissions, as well as apologies, by how difficult it is to obtain them."[23] The symbolic power of apologies—the moral statement that they make as deliberate and symbolic statements of regret and mourning—means that they can be quite valuable.

Apologies offer accountability, a "reality check" allowing society to admit the harm and set the record straight. Victims' desire for official accountability and recognition of wrongdoing is a powerful one. The moral value of this admission may be more important to victims than monetary compensation. As one reparations advocate said, "'*I don't want a check*. I just want fairness.'"[24]

Apologies can be particularly valuable when they address previously unrecognized harms. In fact, a failure to apologize can, after injustice, constitute a new continuing source of offense. We see this idea in the outraged title of Roy Brooks's essay, entitled "Not Even an Apology?" (in his also-tellingly-named volume *When Sorry Isn't Enough*).[25] Unapologized-for offenses can be open wounds, a "continuing violation," and silence about a harm can become a type of complicity.[26] An apology—even one which does not appear to lead to further restitution—can thus be a way to at least stop the bleeding, precisely because it marks an end to the prior silence and inaction.[27]

Apologies can also open the door to healing through storytelling. Victims often place particular value on the opportunity to tell their stories, and they may derive practical and therapeutic benefits from doing so.[28] Apologies can also lead to much-needed dialogue between victim and perpetrator groups, leading to greater understanding between groups, and potentially transforming perceptions.[29]

The mere words of an apology may seem inadequate as a response to

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[22] MINOW, *supra* note 13, at 114.

[23] BROPHY, *supra* note 11, at 12–13.

[24] BROOKS, *supra* note 8, at 141; *see* BROPHY, *supra* note 11, at 11 (noting that "a sincere apology may be more valuable and meaningful to some victims than money").

[25] Roy L. Brooks, *Not Even an Apology?*, *in* WHEN SORRY ISN'T ENOUGH 309, 309 (Roy L. Brooks ed., 1999); *see also* BROOKS, *supra* note 8, at ix (noting that government has "not even tendered an apology" for either Jim Crow or slavery).

[26] *See* BARKAN, *supra* note 14, at 284 (discussing the idea of continuing violation); MINOW, *supra* note 13, at 94–96, 102–03 (discussing inaction as harm and the particular harm of silence after the Japanese-American internment). Matsuda notes: "Lack of legal redress for racist acts is an injury often more serious than the acts themselves, because it signifies the political non-personhood of victims." Matsuda, *supra* note 14, at 390.

[27] Elazar Barkan notes that "slavery has remained the most glaring example of an unaddressed historical injustice in the United States." BARKAN, *supra* note 14, at 284.

[28] *See* MINOW, *supra* note 13, at 103 (discussing storytelling as a means of healing trauma). Minow explains that "storytelling and public memory" and "reparation through memory" were used as forms of reparations in the case of women kidnapped and abused during war. *Id.* at 103–05.

[29] *See* BARKAN, *supra* note 14, at 288 (arguing that understandings "may be transformed if the debate receives more public attention").

harm; but in some sense, the inadequacy of apology is no different from the general futility of any compensatory reparation. Reparations are always dealing in the realm of fundamentally inadequate responses because money cannot truly compensate victims: "[T]here never has been 'adequate' compensation for nontangible . . . losses."[30] Rather, reparations for mass harm will almost always be limited to ultimately symbolic gestures of acknowledgement and regret. Because society can offer only symbolic responses in any event, the mere symbolic value of apology may not be seen as a problem. The model of justice is restorative, not corrective, and apology can be a very effective restorative tool.

Indeed, because of the inadequacy of all responses, apologies (with their unique moral heft and show of accountability) may be particularly efficacious. Brooks argues that redress without apology would be insufficient to satisfy the moral burden of slavery, and "[o]nly apology is sufficiently endowed to perform such heavy moral lifting."[31] Because of this, he suggests that "redress should be about apology *first and foremost*."[32] Indeed, in the instance of the "comfort women," victims rejected money payments which were not accompanied by an official apology.[33]

Overall, then, apologies can be surprisingly effective. By admitting the inadequacy of all responses, and focusing on the strengths of apology—the moral force of voluntary acceptance of responsibility—society can turn the weakness of apology into a strength. And indeed, apologies are increasingly common. They are a low-cost way to heal societal breaches and can therefore be extremely valuable.[34] Apologies for mass wrongs have proliferated in recent years, prompting Roy Brooks to characterize the era as an "[a]ge of [a]pology."[35]

However, apologies are vulnerable to criticism. Because of the ease with which apologies can be given, there is a risk that they will be given carelessly or cynically, without sincerity, thus becoming mere "hollow" or "empty gestures," or attempts to secure "cheap grace."[36] An insincere

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[30] *Id.* at 290; *see also* MINOW, *supra* note 13, at 100 ("The point of these payments was not to make up for the loss of home, business, opportunity, and standing in the community which these people suffered . . . ."); Matsuda, *supra* note 14, at 395 ("Monetary grants will not compensate for the terrible losses sustained.").

[31] BROOKS, *supra* note 8, at 142.

[32] *Id.*

[33] BARKAN, *supra* note 14, at 324.

[34] *See* Editorial, *'Sorry' Says Something*, L.A. TIMES, July 25, 2009, at A28 (discussing state-level apology for discrimination against Chinese immigrants and concluding that "[i]f an apology can bind up intangible hurts that have endured for decades, then yes, it's worth something").

[35] Brooks, *Not Even an Apology?*, *supra* note 25, at 3.

[36] BROOKS, *supra* note 8, at 143–48; BROPHY, *supra* note 11, at 48–49; Haunani-Kay Trask, *Restitution as a Precondition of Reconciliation: Native Hawaiians and Indigenous Human Rights*, *in* SHOULD AMERICA PAY?, SLAVERY AND THE RAGING DEBATE ON REPARATIONS 32, 44 (Raymond A. Winbush ed., 2003).

apology may show neither real commitment to change nor acceptance of blame for wrongdoing.[37] Because the apology's only power is its moral heft, insincerity potentially strips apologies of *all* value—and can even make them into an insult or further injury. Apologies may be valuable if sincere, but completely worthless if insincere.

How does one demonstrate the sincerity of an apology? One way is for the apologizer to take full acceptance of responsibility rather than offering excuses or justifications or otherwise attempting to minimize the gravity of the harm.[38] An effective apology contains a straightforward admission of wrongdoing. For instance, when apologizing to Japanese-Americans, President Reagan said outright that "here we admit wrong."[39] Minow describes a sincere apology as one where "the apologizer assumes a position of vulnerability before not only the victims but also the larger community."[40] This may be difficult for state actors, where personal indicators of sincerity are not available.

A second way to demonstrate sincerity is through further reparative action. Thus, Brooks writes that "[r]eparations are essential to . . . mak[ing] apologies believable."[41] These reparations are not intended to compensate for the harm, but to demonstrate the sincerity of the apology, which is the more important moral act. Without this kind of proof, victims cannot be certain of the apology's sincerity—"[s]imply saying 'I'm sorry' is never enough when righting an atrocity."[42] This kind of demonstration is particularly important in the context of state apologies: "If unaccompanied by direct and immediate action, such as monetary reparations, official apologies risk seeming meaningless."[43]

A sincere apology does not necessarily mean cash payments. One common objection to reparations is that slave descendants are simply seeking large personal payouts. In fact, many advocates favor other plans.[44] Brooks states explicitly that individual checks would make poor reparations for slavery; he instead favors responses which help tell the

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[37] *See* MINOW, *supra* note 13, at 112; BROPHY, *supra* note 11, at 48.

[38] *See* Posting of Annika Mengisen to New York Times Freakonomics Blog, http://freakonomics.blogs.nytimes.com/2009/01/16/whats-the-point-of-saying-youre-sorry/ (Jan. 16, 2009, 11:56 EST) (noting that "a first step in offering an apology is the acceptance of responsibility" while "an ineffective apology is one that is equivocal in acknowledging the wrongdoing and in accepting responsibility").

[39] MINOW, *supra* note 13, at 112–13.

[40] *Id.* at 114. As Minow states, "[to] apologize is to declare voluntarily that one has *no* excuse, defense, justification, or explanation for an action . . . . Any diversion from accepting responsibility is not an apology. . . . Full acceptance of responsibility by the wrongdoer is the hallmark of an apology." *Id.* at 114–15 (alterations in original).

[41] BROOKS, *supra* note 8, at 142.

[42] *Id.* at 155.

[43] MINOW, *supra* note 13, at 117.

[44] Brophy defines reparations as including all "legislative and court action designed to address historic injustices" and clearly states that "reparations do not *necessarily* have to include payments." BROPHY, *supra* note 11, at xiii, 11.

stories of slaves, preserve their memory, and strengthen the community. These include a national slavery museum, as well as trust funds to help Blacks establish businesses and receive an education.[45]

IV. THE SENATE APOLOGY

Thus, stand-alone apologies can have value; however, they raise real concerns about their sincerity. How does this analysis apply to the Senate apology?

Like the House resolution, the Senate apology contains very harsh words for slavery,[46] and also like the House resolution, the Senate apology does not provide any monetary reparations.[47] However, the Senate's explicit disclaimer creates some very different effects.

The disclaimer has both legal and symbolic importance. Its legal effect is as it states—simply that it cannot be used to support reparations. There is nothing in the Senate apology that outright blocks any future reparations. Further reparations legislation is still possible, but would require separate legislation which could not use the apology as legal support. Nor could a court use the apology as a legal ground for finding liability.[48] This is a relatively minor consequence, because as noted earlier, there is no direct legal link between apology and payment. Federal and state governments have apologized for a number of past events, without creating legal liability.

The symbolic effects of the disclaimer are much broader. The disclaimer is a preemptive, symbolic rejection of compensation, and alters the symbolic content of the apology in significant ways.

First, it shows doubt for the apology recipients, casting them as greedy overreachers who must be forestalled in advance. Other official apologies have not included disclaimer language, and its inclusion here implies that slave descendants may be particularly untrustworthy. In the same way that a lack of apology can keep wounds unhealed, this mistrusting apology potentially opens new wounds by casting aspersions on the very people to whom it purports to apologize.

Second, the disclaimer is inconsistent with the acceptance of responsibility that is the hallmark of sincere apology. A sincere apology accepts responsibility for wrongdoing and accepts appropriate consequences, wherever they may lead. But this disclaimer makes clear that the apology extends only to a certain (limited and painless) point.

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[45] BROOKS, *supra* note 8, at 157.

[46] *See* S. Con. Res. 26, *supra* note 4 (noting prolonged and various forms of suffering).

[47] *Id.* § 2 (stating that nothing in the resolution serves as a settlement).

[48] This has not prevented some reparations opponents from characterizing it as "a slick way to get the camel's nose into the tent for future reparations." *See* Walter Williams, *Senate Slavery Apology*, HUMAN EVENTS, July 8, 2009, http://www.humanevents.com/article.php?id=32596.

In fact, the disclaimer undercuts both ways that scholars have suggested for showing sincerity. Minow suggests apology as full accountability and vulnerability. However, the Senate's deliberate action to block future steps is a refusal to fully take responsibility or to create the voluntary vulnerability which makes apology effective.

The disclaimer also blocks the possibility of showing sincerity though further reparative action, as suggested by Brooks. The apology takes the first step towards an atonement as Brooks articulates, but then blocks the second, equally necessary step. The atonement process is incomplete without the second step, and the attitude evinced by the disclaimer creates some doubt as to whether the second step will ever happen. To be fair, other apologies that have not been followed by reparations (such as the House apology) have been equally incomplete. But the Senate apology is deliberately and consciously incomplete in a new way.

Because of these problems, one might expect the Senate apology to fail at creating the healing sought by restorative justice. Apologies are already stripped-down remedies, offering only symbolic content, and most powerful when they set the record straight, show commitment to change, and encourage reconciliation and healing. This apology, framed as "I'm sorry, but—", seems unlikely to have that power.

Not surprisingly, reactions to the apology have been mixed. A significant number of critics have articulated these concerns. For instance, Representative Bennie Thompson said that "[p]utting in a disclaimer takes away from the meaning of an apology."[49] Randall Robinson warned that without further reparation, "we haven't accomplished anything."[50]

But the apology has been welcomed by many other commentators. The NAACP is among the most prominent supporters, calling the apology "the first step toward healing the wounds of African-American men and women throughout this country."[51] Similarly, entertainer Russell Simmons wrote on *The Huffington Post* that "the healing has begun."[52] Writer Terence Samuel offered a more mixed endorsement on *The Root* website, criticizing the disclaimer and characterizing the apology as "shockingly late," but ultimately concluding, "apology accepted."[53] Another editorial,

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[49] William Douglas, *Slavery Apology Has Disclaimer*, DENVER POST, June 19, 2009, http://www.denverpost.com/election08/ci_12625083.

[50] Thompson, *supra* note 1. Another editorial argued that the apology would be ineffective without additional steps to "go beyond symbolism" and help remedy racial gaps in education. *See* Glenda Overstreet, *Apology Can't Stand Alone*, TOPEKA CAPITAL J., June 28, 2009, at 2.

[51] Press Release, NAACP, NAACP Applauds U.S. Senate for Passing Bipartisan Resolution Apologizing for the Enslavement and Racial Segregation of African-Americans (June 19, 2009), *available at* http://www.naacp.org/news/press/2009-06-19/index.htm.

[52] Russell Simmons, *The Healing Has Begun: U.S. Senate Apologizes for Slavery*, HUFFINGTON POST, June 19, 2009, http://www.huffingtonpost.com/russell-simmons/the-healing-has-begunus-s_b_217901.html.

[53] Terence Samuel, *Senate Apologizes for Slavery*, THE ROOT, June 18, 2008, http://www.theroot.com/views/senate-apologizes-slavery.

while calling the apology "long overdue," also concluded that "it's never too late for a needed apology."[54] And President Barack Obama praised the historic nature of the apology in remarks a few days later commemorating Juneteenth, the anniversary of slave freedom.[55]

The positive reactions to the apology illustrate a key factor too often ignored in the reparations debate—that many Blacks desperately *want* to accept an apology, even a flawed one. Blacks are deeply interested in healing the community, and are willing to accept gestures that seem capable of aiding reconciliation.

And it is clear that, despite its flaws, the apology has indeed created benefits. It placed the topic into the Congressional Record;[56] it sparked national dialog about slavery, reparations, and race issues (the month following the apology saw 172 news stories on the topic);[57] and it opened the door to further storytelling and advocacy.[58] These opportunities are invaluable, since storytelling can be a powerful tool to explode myths like the popular idea that slavery was limited to the South.[59]

In raising consciousness about slavery (with a damning description of the institution), the apology builds on and combines with earlier actions, such as the House apology and President Clinton's remarks on racism, which may not have not fully permeated societal consciousness.[60] A critical mass of public discussion is necessary to change perceptions; this apology is one step in that process.[61]

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[54] Editorial, *Our Turn: Slavery Apology is Long Overdue*, SAN ANTONIO EXPRESS-NEWS, July 7, 2009, at 8A.

[55] *See* AFP News, *Obama Praises 'Historic' Senate Slavery Apology*, June 18, 2009, *available at* http://www.google.com/hostednews/afp/article/ALeqM5iyMeHvk7WyJys7iAyehSzik11Yqg.

[56] *See id.* (discussing the resolution passed by the Senate which apologized for slavery).

[57] A Westlaw Search in ALLNEWS for <"slavery & apology & da(aft 6/17/2009 & bef 7/18/2009)">, conducted on August 10, 2009, yielded 172 news stories on the topic. S*ee also* Mengisen, *supra* note 38 (characterizing effective apologies as those which "raise public knowledge and political concern").

[58] *See* Katrina Browne, *Commentary: Slavery Needs More Than an Apology*, CNN, Aug. 19, 2009, http://edition.cnn.com/2009/POLITICS/08/19/browne.slavery/ (noting some of slavery's history and its impact on current society).

[59] *See id.* (discussing slave trading in Rhode Island). For other powerful examples of storytelling see, e.g., Alfred L. Brophy, *Considering William and Mary's History with Slavery: The Case of President Thomas Roderick Dew*, 16 WM. & MARY BILL RTS. J. 1091, 1106–07 (2008) (discussing relatively little-known aspects of slave history at William and Mary); Gabriel J. Chin & Randy Wagner, *The Tyranny of the Minority: Jim Crow and the Counter-Majoritarian Difficulty*, 43 HARV. C.R.-C.L. L. REV. 65, 87–94 (2008) (recounting the little-known history of how Black voters in majority areas in the South were disenfranchised); Richard Delgado, *Storytelling for Oppositionists and Others: A Plea for Narrative*, 87 MICH. L. REV. 2411, 2412 (1989) (discussing the power of narratives).

[60] *See* BARKAN, *supra* note 14, at 287 (describing President Clinton's "'unplanned' semiapology" on his African tour in 1998); BROPHY, *supra* note 11, at 13 ("His remarks represented condemnation and contrition, even though he never apologized.").

[61] Public perception of reparations remains intensely fractured. *See* Alfred Brophy, *The Cultural War over Reparations for Slavery*, 53 DEPAUL L. REV. 1181, 1182–84 (2004) (noting different positions on reparations); *see also* Kaimipono David Wenger, *Causation and Attenuation in the Slavery Reparations Debate*, 40 U.S.F. L. Rev. 279, 280–82 (2006) (discussing different views on reparations).

Apology without action is meaningless; but in this case, the state has (slowly) taken prior actions to remedy the worst of slavery's inequalities. Slavery ended with the Thirteenth Amendment. Legislative and court action eventually ended Jim Crow and other *de jure* segregation, and extended the vote and other civil rights to Blacks. The order of events here is backwards—usually apology comes first, then substantive change—but many important substantive changes have already occurred, and now the apology can reinforce those changes.

On balance, the apology looks like a moderate success. The disclaimer is unsavory but may have been a political necessity. Meanwhile, the benefits of the apology—the official expression of regret, the resulting dialog, and the Black eagerness to accept the gesture—suggest that the flawed apology was better than no apology at all.

Could it also be a stepping stone toward something more? Surprisingly, the answer may be yes. It is too late to try to remove the bad feelings caused by the disclaimer, but it may not be too late to take additional steps to show good faith. The Senate apology blocks monetary claims, but, as noted earlier, not all reparations need be monetary.

The Senate should follow the apology with bold symbolic gestures that show its seriousness and sincerity. Roy Brooks has suggested building a national slavery museum as one such gesture.[62] A semiprivate museum was started but has stalled.[63] The Senate should take charge of funding and completing this museum, creating a focal point to raise consciousness about slavery and tell slaves' stories. At the same time, the Senate should make Juneteenth into a new national holiday, which will further reinforce and annually renew the discussions generated by the apology.

Senate action to fund a serious national museum on slavery and to formally commemorate Juneteenth would help show the sincerity of the apology. These measures would not satisfy all activists, but they would imbue the Senate's apology with more than mere words. The apology would then more effectively further the restorative justice goals of reparations, and would serve as a helpful model for the future.[64]

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[62] *See* BROOKS, *supra* note 8, at 157.

[63] *See* Pamela Gould, *Slavery Museum's Future in Doubt*, FREDERICKSBURG.COM, Feb. 21, 2009, http://fredericksburg.com/News/FLS/2009/022009/02212009/446477 (discussing the announcement of a museum and the lack of construction of said museum); *see also* Dionne Walker, *National Slavery Museum Project Stalls*, USA TODAY, Mar. 18, 2008, http://www.usatoday.com/travel/news/2008-03-18-national-slavery-museum_N.htm (mentioning the cloudy future of the planned museum).

[64] *See* Wenger, *supra* note 6 (suggesting that state and local apologies have become increasingly important and will only continue to grow in importance).

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Hitting the Sweet Spot by Accident: How Recent Lower Court Cases Help Realign Incentives in the Credit Rating Industry

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I. INTRODUCTION

Broad reliance on excessively optimistic credit ratings of structured financial products[1] helped ignite and spread the recent financial crisis. A misalignment of incentives at rating agencies such as Fitch Inc., Moody's Corporation, and Standard & Poor's ("S&P") contributed significantly to this excessive optimism. One proposal for better aligning incentives is to facilitate more lawsuits against the rating agencies for shoddy work. Courts have traditionally dismissed such lawsuits, deeming ratings to be fully protected speech under the First Amendment. However, two recent district court cases, *Abu Dhabi Commercial Bank v. Morgan Stanley & Co.*,[2] and In re *National Century Financial Enterprises, Inc., Investment Litigation*,[3] adopt a different view. They hold that ratings on securities sold in private placements, as distinct from public offerings, do not constitute matters of public concern, and do not qualify for full First Amendment protection. Many of the structured finance products at the heart of the financial crisis were sold in private placements, while most

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[1] "Structured finance" refers to the issuance by bankruptcy-remote, special-purpose entities of securities with graduated repayment priorities. The special purpose entities are in turn collateralized by assets such as mortgages or credit card receivables.

[2] No. 08-CV-7508, 2009 WL 2828018, at *9 (S.D.N.Y. Sept. 2, 2009).

[3] 580 F. Supp. 2d 630, 640 (S.D. Ohio 2008).

corporate debt is sold in public offerings. This Essay argues that in the structured finance arena, the costs of facilitating litigation against the rating agencies are lower, and the potential benefits greater, than in traditional corporate finance. Irrespective of constitutional merits, good economic policy may prescribe facilitating lawsuits in structured finance but not in traditional corporate finance. By happy coincidence, the holdings in *Abu Dhabi Commercial Bank* and *National Century* approximate this result.

II. HOW INFLATED RATINGS FED THE CRISIS

Ratings pervade the architecture of debt markets. A raft of federal regulations restrict what securities banks and various investment vehicles may hold based on credit ratings.[4] Most investment funds have internal guidelines that impose further ratings-based restrictions on fund managers.[5] These restrictions aim to limit the risk that banks or fund managers assume. They help address the danger that a fund manager will increase his or her compensation by imposing unwanted risk on investors, or that a bank will impose unwanted risk on depositors and the deposit insurer.

Sufficiently high ratings from an approved agency[6] are prerequisites to the broad salability of most debt instruments. Ratings allow mortgage lenders—directly or through third-party arrangers—to securitize claims on mortgages that will pay out over a number of years (if all goes well) and sell them for upfront cash, which they can then re-lend, starting the process anew. Securities sold against pools of home mortgages are called residential mortgage-backed securities ("RMBS"). RMBS are issued in a hierarchy of "tranches," with repayment priority for higher-rated tranches. Mid- and lower-level RMBS tranches are often pooled with other RMBS and/or securities from other structured financial products, and collateralized debt obligations ("CDOs") are sold against this pool, again in a hierarchy of tranches. CDOs were essential to an active RMBS market, as the CDOs were the primary purchasers of the lower-rated RMBS tranches; without the sale of the most junior, "first-loss" tranches of securitized pools of assets, most deals could not go forward.[7]

High ratings on RMBS and CDOs contributed to a high degree of liquidity in the mortgage market; overly optimistic ratings contributed to

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[4] *See* Frank Partnoy, *The Siskel and Ebert of Financial Markets: Two Thumbs Down for the Credit Rating Agencies*, 77 WASH. U. L.Q. 619, 690–703 (1999).

[5] Richard Cantor et al., *The Use of Credit Ratings in Investment Management in the US and Europe* (Working Paper Feb. 16, 2007), *available at* http://ssrn.com/abstract=996133.

[6] An "approved agency" is one recognized by the Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization ("NRSRO").

[7] *See* Joseph R. Mason & Joshua Rosner, *Where Did the Risk Go? How Misapplied Bond Ratings Cause Mortgage Backed Securities and Collateralized Debt Obligation Market Disruptions* 69–72 (Working Paper May 14, 2007), *available at* http://ssrn.com/abstract=1027475.

excessive liquidity, as investors were willing to fund mortgages at rates that fell far short of compensating them for the actual risk. This helped feed the real estate bubble.

When the bubble burst, the breakdown in investor confidence in ratings helped the crisis spread to the broader financial system. The highest rated RMBS and CDO tranches constituted what Gary Gorton has termed "informationally insensitive" debt, or debt that "is very liquid because its value rarely changes and so . . . can be traded without fear that some people have secret information about the value of the debt."[8] Debt obligations with the highest agency ratings were viewed as informationally insensitive, or safe.

When the crisis hit, there were approximately 37,000 structured finance tranches in the United States with AAA ratings (the highest possible rating).[9] These highly rated securities helped lubricate the broader economy as institutions used them as collateral in a variety of transactions. Perhaps most importantly, institutions with large temporary cash surpluses would, instead of depositing the money in a commercial bank (where deposit insurance was capped prior to the crisis at $100,000 per account), lend the money to other financial institutions with short-term cash needs, and accept AAA-rated RMBS and CDO securities, inter alia, as collateral. These loans—called repurchase ("repo") agreements—were usually for a single night, but could be rolled over indefinitely by mutual consent. They were viewed as risk-free, with rates of return essentially equal to that of Treasury bills. Estimates of the size of the repo market before the crisis were as high as $10 trillion.[10] It constituted a parallel (unregulated) banking system as large as the commercial banking system. For it to work smoothly, collateral had to be informationally insensitive—parties could not spend time worrying about its value. When home prices started falling, investors saw risk where previously they had seen only safety in highly rated mortgage-backed securities. They hoarded cash and stopped rolling over repo loans. Investors knew the system was insolvent, but information about the location of losses—which securities were toxic and to what degree—was startlingly opaque.[11] Suddenly, the value of AAA-rated securities became highly informationally sensitive, but no one possessed the relevant information. "Not only [did] information now have to be produced, but the expertise [was] lacking"[12]—and this because of the prior

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[8] Gary Gorton, *Slapped in the Face by the Invisible Hand: Banking and the Panic of 2007*, at 4 (Yale Sch. Mgmt. Working Paper, May 9, 2009), *available at* http://ssrn.com/abstract=1401882.

[9] Joshua D. Coval et al., *The Economics of Structured Finance* 3–4 (Harv. Bus. Sch. Fin. Working Paper No. 09-060, Oct. 20, 2008), *available at* http://ssrn.com/abstract=1287363.

[10] Gorton, *supra* note 8, at 30.

[11] *See* Gary Gorton, *The Subprime Panic* 1 (Yale Int'l Ctr. for Fin., Working Paper No. 08-25, 2008), *available at* http://ssrn.com/abstract=1276047.

[12] Gorton, *supra* note 8, at 37.

heavy reliance on what turned out to be highly flawed ratings.

Thus began a "run" on the parallel banking system—the refusal to roll over repo loans was the functional equivalent of depositor withdrawals—with all the adverse systemic consequences of previous banking crises. Indeed, the consequences were worse, as ratings-based rules and capital requirements forced institutions to sell securities into illiquid markets, driving down prices, which forced other institutions to mark down the value of comparable securities and to hold their own fire sales to maintain required capital ratios, feeding a vicious cycle.

III. HOW THE RATING AGENCIES GOT IT WRONG

The ratings agencies' errors in rating mortgage-backed securities contributed to and exacerbated the crisis. How did they get things so wrong? In contrast to the more qualitative judgments about credit risk applied to corporate issuers, agencies relied primarily on statistical models in rating structured financial instruments.[13] In hindsight, the rating agencies fed the models unrealistically optimistic assumptions about continuing house price appreciation, the probability of borrower defaults, and correlation among defaults.[14] In corporate finance, a rating error on one firm is unlikely to be replicated in the analysis of other firms, as analysis focuses on the idiosyncratic risks of the individual business. In structured finance, however, models are applied to whole classes of issuances, and model error affected the ratings on broad swaths of securities.

Why did they make such unrealistic assumptions? Critics point to a conflict of interest at the core of the business model of the major rating agencies: they rate debt as a service to investors, but issuers pay their bills.[15] Issuers have a strong incentive to attain the highest possible rating, as higher ratings decrease the perceived risk of default, thus raising the price that investors will pay for the debt. Due to the payment structure, it is possible that rating agencies may bow to issuers' pressure to inflate ratings in order to keep their business.

In theory, rating agencies resist this pressure because of the desire to maintain a good reputation: if investors no longer trust rating agencies, they will not pay a premium for more highly rated securities, and issuers will have no incentive to pay to attain those ratings. Compromising quality standards today will harm the rating agencies' business in the long run.

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[13] *See, e.g.*, Mason & Rosner, *supra* note 7, at 17 (noting that "structured-finance rating analysis is essentially driven by statistical analysis").

[14] *See* Coval et al., *supra* note 9, at 2–4, 17 (explaining errors made when utilizing the models).

[15] *See, e.g.*, U.S. SEC. & EXCH. COMM'N, SUMMARY REPORT OF ISSUES IDENTIFIED IN THE COMMISSION STAFF'S EXAMINATION OF SELECT CREDIT RATING AGENCIES 23 (July 2008), *available at* http://www.sec.gov/news/studies/2008/craexamination070808.pdf.

This explanation carries some force, but two factors significantly attenuate the reputation mechanism. First, as outlined above, many securities require ratings for target investors to be able to buy them. Critics believe that rating agencies' primary function now is to provide regulatory licenses for the sale of securities, rather than to serve as reputational intermediaries.[16] In this view, reputation provides no meaningful constraint on the rating agencies, as demand will remain stable and they will continue to profit regardless of the accuracy of their ratings. A 2008 *Wall Street Journal* editorial asked, "How badly do the major credit-rating firms have to perform before investors stop using their services? That's a trick question, because investors aren't allowed to stop using them."[17]

The second factor working against reputation as a bulwark against the deterioration of rating quality is the tension between long-term and short-term incentives within the firms. It can take a long time for poor ratings quality to become apparent. A former Moody's managing director explains, "It is argued that building a stellar reputation requires a long-term horizon and view. Yet managers of publicly owned rating agencies are subject to intense short-term pressure to demonstrate earnings growth. It takes tremendous discipline to turn away business, particularly when competitors are building market share."[18]

There is anecdotal evidence that rating agencies did not always exercise this discipline. According to notes subpoenaed for congressional hearings, Moody's chief executive officer stated at one internal presentation that Moody's employees "'are continually pitched by bankers, issuers, investors' and sometimes 'we drink the kool-aid.'"[19] In another internal town hall meeting, he stated:

> "What happened in '04 and '05 with respect to subordinated tranches is that our competition, Fitch and S&P, went nuts. Everything was investment grade. It didn't really matter. . . . We tried to alert the market. We said we're not rating it. This stuff isn't investment grade. No one cared . . . ."[20]

Issuers exploited their position as paying customers by seeking out

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[16] *See* Partnoy, *supra* note 4, at 681–703. Note that until recently it was next to impossible to attain NRSRO status—the major credit rating agencies were all "grandfathered" in. The Credit Rating Agency Reform Act of 2006 and subsequent rule changes have eased the process. *See* 17 C.F.R. § 240.17g-1. There are now ten firms with the official designation, but under the regulatory license view, this is unlikely to improve accuracy.

[17] Editorial, *The Ratings Racket*, WALL ST. J., June 25, 2008, at A14.

[18] Jerome Fons, *White Paper on Rating Competition and Structured Finance* 2 (Fons Risk Solutions, Working Paper, 2008), *available at* http://www.fonsrisksolutions.com/Documents/Ratings%20White%20Paper.pdf.

[19] *Credit Rating Agencies and the Financial Crisis*, 110th Cong. 2 (2008) (statement of Rep. Waxman, Chairman, House Comm. on Oversight and Gov't Reform) (quoting statements made by Ray McDaniel, CEO of Moody's).

[20] *Id.*

agencies whose models most liberally assigned top ratings and channeling business to them. Two trends made this "ratings shopping"[21] more severe in structured finance than in corporate finance: issuers' willingness to eschew the services of Moody's or S&P for Fitch, and their willingness to use one rater rather than two,[22] as is the norm in corporate finance.[23] Raters are likely to be more sensitive to issuers' concerns if issuers can plausibly threaten not to use their services. For large public offerings, Moody's and S&P usually preempt such shopping by assigning unsolicited ratings.[24] This is impossible to do for most private placements, where key information is nonpublic. Rating shopping, combined with the conflict of interest inherent in the issuer-pays model, contributed to a systemic inflation of ratings on structured products, which in turn contributed to both the real estate bubble and the pernicious consequences of its bursting.

IV. ONE WAY TO IMPOSE DISCIPLINE ON RATING AGENCIES

One way to impose discipline on rating agencies is to expose them to liability for shoddy work. If the desire to please clients and win business inspires excessive optimism, the threat of lawsuits for failing to base ratings on sound analysis can push in the opposite direction. The costs and benefits of such lawsuits weigh differently in structured finance than in traditional corporate finance. Rating agencies' conflict of interest is more severe in structured finance, as losing a client has a bigger impact on profits. In 2006, structured finance accounted for forty-four percent of Moody's business, while traditional corporate finance accounted for just thirty-two percent.[25] In corporate finance, thousands of distinct issuers contribute to the revenue stream, and losing any one of them would not cause serious harm to the bottom line. In structured finance, a dozen big banks dominate the market.[26] Incurring the disfavor of one of these banks could significantly harm profits, especially as an issuer's threat to take its business elsewhere carries more force in structured finance. Further, to the degree that information is more often private and the models complex in structured finance, it may take longer for investors to realize ratings errors, which could exacerbate the short-term outlook of rating agency decision-

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[21] *See* ANDREW CARRON ET AL., NERA ECON. CONSULTING, CREDIT RATINGS FOR STRUCTURED PRODUCTS 31–32 (2003), *available at* http://www.nera.com/image/6384.pdf (discussing distribution of credit ratings by degree of subordination and the idea of "ratings shopping").

[22] *See id.* at Exhibit III.2. (showing an increase in the number of ratings using only one rating agency instead of a combination of two or more).

[23] *See* John C. Coffee, Jr., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 286–87 (2006) (discussing examples of industry-accepted rating systems used in corporate finance).

[24] Carol Ann Frost, Credit Rating Agencies in Capital Markets: A Review of Research Evidence on Selected Criticisms of the Agencies 20 (unpublished working paper, on file with Univ. North Texas; State Univ. New York at Buffalo, 2006), *available at* http://ssrn.com/abstract=904077.

[25] Coval et al., *supra* note 9, at 4.

[26] Mason & Rosner, *supra* note 7, at 9–10.

makers. In structured finance, it is easier for rating agencies to hide manipulative practices, at least in the short run, which translates to a bigger market failure that litigation might address.

The primary cost of permitting suits to go forward is that any downgrade would presumably invite a lawsuit, however frivolous. This could lead to excessive conservatism in ratings and delays in downgrades. The effect of litigation on systemic accuracy, then, is ambiguous. In structured finance, however, this poses less serious concerns, as investors are overwhelmingly sophisticated institutions that would be unlikely to team with plaintiffs' attorneys to launch frivolous suits.

In short, the reputational mechanism is weaker in structured finance than in traditional corporate finance, the conflicts of interest are more severe, and litigation costs are lower. All of these factors make exposure to lawsuits by investors more appropriate in structured finance than in corporate finance.

V. THE FIRST AMENDMENT AND RECENT CASES

Lawsuits against rating agencies have traditionally faced a formidable barrier: the First Amendment. Courts have accepted rating agencies' arguments that their ratings are opinions on matters of public concern, and are fully protected speech under the First Amendment, subject to the "actual malice" exception.[27]

Abu Dhabi Commercial Bank and *National Century*, however, depart from this traditional deference to ratings. They hold that ratings on instruments sold in private placements, because they are published to a limited group of targeted investors instead of to the world at large, do not constitute matters of "public concern," and hence do not qualify for full First Amendment protection.[28] In practice, this means that plaintiffs need not show actual malice, but may, for example, sue for negligent misrepresentation.

Both decisions rely on the Supreme Court's ruling in *Dun & Bradstreet, Inc. v. Greenmoss Builders*.[29] In *Dun & Bradstreet*, a credit reporting agency[30] erroneously sent five subscribing banks a confidential report that a small local business had filed for bankruptcy. The business

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[27] New York Times Co. v. Sullivan, 376 U.S. 254, 279–80 (1964). "Actual malice" is a legal term of art that translates to knowledge of falsity, or reckless disregard for whether a statement is true or false. *Id.*

[28] Abu Dhabi Commercial Bank v. Morgan Stanley & Co., Inc., No. 08-CV-7508, 2009 WL 2828018, at *9 (S.D.N.Y. Sept. 2, 2009); *In re* Nat'l Century Fin. Enters., Inc., 580 F. Supp. 2d 630, 640 (S.D. Ohio 2008).

[29] 472 U.S. 749, 763 (1985).

[30] Credit reporting agencies are distinct from credit rating agencies. They collect and report the credit histories of individuals and smaller businesses—entities likely to seek financing from a bank rather than the capital markets. They do not issue opinions on the creditworthiness of corporate bonds or structured financial instruments.

sued for defamation.[31] The Court rejected Dun & Bradstreet's First Amendment defense, holding that because its report was made available on a confidential basis to a small number of paying subscribers, it was not a matter of public concern.[32] Dun & Bradstreet could be held liable, therefore, even without a showing of actual malice.

One should note that *Dun & Bradstreet* is not necessarily dispositive of First Amendment arguments by rating agencies in the context of private placements. Privately placed bonds are generally sold to institutions representing thousands of small investors, making them more a matter of public concern than the solvency of a small local company. Further, ratings on the bonds, while published in documents sent only to targeted investors, are not confidential; a concerned party could ascertain such ratings with relative ease. Dun & Bradstreet also made a factual statement that was demonstrably false and harmful to its subject's reputation; the rating agencies in these cases issued opinions that, in retrospect, were not harmful enough to their subjects' reputations. Nonetheless, *Dun & Bradstreet* is essential to the courts' conclusions in *Abu Dhabi Commercial Bank* and *National Century*.

A. Abu Dhabi Commercial Bank

In *Abu Dhabi Commercial Bank*, two institutional investors sued Moody's, S&P, Morgan Stanley, and several other institutions involved in the arrangement, marketing, and management of a structured investment vehicle ("SIV") called the Cheyne SIV.[33] An SIV typically buys CDOs, RMBS, and other asset-backed securities with long maturities, and issues short-term notes to investors. Because longer-term assets are viewed as relatively riskier and thus demand higher interest rates, SIVs profit from the difference in interest rates between their long-term assets and their short-term liabilities. The SIV market essentially disappeared with the onset of the financial crisis.

According to the allegations in this case, the selling documents for the Cheyne SIV listed the rating agencies' responsibilities. These responsibilities included active monitoring of the SIV and approval authority for changes to the SIV's portfolio. Two specific responsibilities were to ensure the SIV's rated notes "would be supported by at least forty percent 'AAA'—and at least sixty percent 'AA'—collateral assets," and that "the amount of RMBS supporting the Cheyne SIV would never exceed fifty-five percent."[34]

The complaint further alleged that S&P and Moody's received larger-

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[31] *Dun & Bradstreet*, 472 U.S. at 751–52.
[32] *Id.* at 762.
[33] *Abu Dhabi Commercial Bank*, 2009 WL 2828018, at *1.
[34] *Id.* at *4.

than-usual fees for the deal and knew the fees were contingent on the provision of sufficiently high ratings.[35] The plaintiffs also claimed that shortly before they bought notes from the Cheyne SIV, S&P and Moody's both came out with new "models that eased . . . standards for evaluating the creditworthiness of nonprime securities like the Cheyne SIV."[36] Perhaps most damning, the rating agencies allegedly sat idly by as RMBS came to make up more than fifty-five percent of the Cheyne SIV portfolio, and AAA- and AA-rated assets both fell below the thresholds promised in the selling documents.[37]

After the Cheyne SIV failed in 2007, the plaintiffs brought claims for, inter alia, negligence, negligent misrepresentation, and common law fraud against S&P, Moody's, and the other defendants.[38] Because the court's ruling was in response to a Rule 12(b)(6) motion, it assumed that all the allegations were true in determining whether the claims could go forward. The court ruled that New York's Martin Act[39] barred all private securities-related claims that "do not require proof of deceitful intent."[40] So, for example, private litigants in New York can press state law securities fraud claims, but only the state attorney general can pursue a negligence claim in a securities case. The court thus dismissed every claim except for common law fraud against the rating agencies and Morgan Stanley.[41]

Relying on *Dun & Bradstreet*, the court rejected the rating agencies' claim to full First Amendment protection. It reasoned that because ratings were published only in documents distributed to a limited number of target investors, they were not a matter of public concern. The rating agencies could thus be held liable for damages without a showing of actual malice.[42] The court's ruling on this issue was arguably unnecessary, as the only claim to survive its order, common law fraud, requires showing "the defendant possesses an intent to deceive, manipulate or defraud."[43] Because such intent would entail knowledge of falsity, it should automatically trigger the "actual malice" exception to First Amendment protection. The First Amendment would not protect the rating agencies against a fraud claim even for publicly issued ratings. Nonetheless, the court's decision is sure to have an impact on other cases that involve allegations of negligence or negligent misrepresentation on the part of the rating agencies—perhaps even cases brought by New York's Attorney

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[35] *Id.* at *3.
[36] *Id.* at *11.
[37] *Id.* at *4.
[38] *Id.* at *1.
[39] N.Y. GEN. BUS. LAW § 352-c (1996).
[40] *Abu Dhabi Commercial Bank*, 2009 WL 2828018, at *7 (internal quotation marks omitted).
[41] The Martin Act was only one basis for the dismissal of the other claims. The court also, for example, dismissed the plaintiffs' claims for breach of contract on other grounds. *Id.* at *19.
[42] *Id.* at *9.
[43] *Id.* at *6 (internal quotation marks omitted).

General.

B. National Century

The litigation in *National Century* pre-dated the financial crisis. It arose out of a massive fraud at the Ohio-based National Century Financial Enterprises, Inc., which collapsed in 2002.[44] The company provided loans to healthcare providers to cover the period between patient treatment and reimbursement by third-party insurers.[45] In a structure akin to RMBS, it packaged these loans into (supposedly) bankruptcy-remote vehicles, which then issued notes to investors secured by the healthcare loan receivables.[46] The vehicle at issue in this case, NPF XII, sold separate series of privately placed notes over time. Lloyds TSB Bank PLC purchased notes in a series rated by Moody's, and a group of New York-based public pension funds (with Lloyds, the "plaintiffs") purchased notes in a series rated by Fitch.[47] After the notes defaulted, the plaintiffs sued the rating agencies separately, and the cases were consolidated. The judge's decision was an order in response to a Rule 12(b)(6) motion by the rating agencies.[48]

The plaintiffs' suit against the agencies included claims of fraud, aiding and abetting fraud, and negligent misrepresentation, inter alia.[49] The plaintiffs claimed that both rating agencies had access to information that should have alerted them to National Century's noncompliance with the terms in its Master Indenture, and that would have undermined the high ratings they had assigned to the NPF XII notes.[50] The plaintiffs claimed, for instance, that Fitch received three anonymous letters outlining the fraud at National Century, but after an investigation determined the letters were baseless.[51]

The court concluded that the plaintiffs failed to state a claim of fraud because they did not plead with sufficient particularity.[52] As fraud was the only claim likely to qualify for the actual malice exception, the court's ruling on the agencies' First Amendment defense was crucial to the survival of the lawsuit. The court found "that the complaint [did] not

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[44] Press Release, Dep't of Justice, Former National Century Financial Enterprises CEO Sentenced to 30 Years in Prison, Co-Owner Sentenced to 25 Years in Prison for Conspiracy, Fraud and Money Laundering (Mar. 27, 2009), *available at* http://www.justice.gov/opa/pr/2009/March/09-crm-282.html.

[45] David Hammer, *Former Executives of Loan Company Charged with Fraud*, ASSOCIATED PRESS FINANCIAL WIRE, May 23, 2006.

[46] *See* Harold L. Kaplan & Stephanie Wickouski, *Health Care Financing and Securitization After* National Century, AM. BANKR. INST. J., May 2003, *available at* http://www.drinkerbiddle.com/files/Publication/d5263820-0353-4db6-abbd-3a818e490977/Presentation/PublicationAttachment/0bb58994-e659-4d3b-8bec-361d2fb1e32d/HCFinancingAfterNationalCenturyABIArticleMay03.pdf.

[47] *In re* Nat'l Century Fin. Enters., Inc., 580 F. Supp. 2d 630, 634–35 (S.D. Ohio 2008).

[48] *Id.* at 636, 638.

[49] *Id.* at 635–36.

[50] *Id.* at 634–36.

[51] *Id.* at 636.

[52] *Id.* at 645.

allege that the ratings of the NPF XII notes were published to the investing public at large."[53] Citing *Dun & Bradstreet* for the proposition that speech to "a specific business audience" does not qualify as a matter of public concern, the court rejected the agencies' First Amendment arguments.[54] The plaintiffs' negligent misrepresentation and other claims thus survived the motion to dismiss.[55]

VI. CONCLUSION

The impact of these decisions will be felt more in structured finance than in corporate finance. Many RMBS and virtually all CDOs are sold in private placements.[56] In contrast, private placements in the United States of "plain vanilla" debt amounted to less than ten percent of total U.S. investment-grade corporate debt issuances in 2006.[57]

Some may criticize the constitutional merits of the opinions, as ratings of bonds purchased by institutions that represent thousands of individual investors are arguably more a matter of public concern than the financial health of a small local company. But irrespective of the constitutional merits of their rulings, the courts have hit upon a potentially happy compromise between exposing rating agencies to excessively burdensome costs, and holding them to account where their conflicts of interest are most severe and the potential adverse impact of inflated ratings on the financial system most pernicious. While the courts' reasoning was entirely distinct from the policy issues outlined above, they fortuitously, if imperfectly, deny full First Amendment protection to a broad swath of structured finance deals, which are largely sold in private placements, while preserving it for most of corporate finance, where public offerings constitute the bulk of the market. Given the theoretical and practical difficulties of effecting a comprehensive solution to the misaligned incentives in the credit rating industry, this outcome marks a positive, if incremental, step in the right direction.

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[53] *Id.* at 640.

[54] *Id.* at 640 (citing Dun & Bradstreet, Inc. v. Greenmoss Builders, 472 U.S. 749, 762 (1985)).

[55] *Id.* at 656. The other claims to survive included violations of blue sky laws and aiding and abetting fraud.

[56] *See* Richard Tomlinson & David Evans, *The Ratings Charade*, BLOOMBERG MARKETS, July 2007, http://www.bloomberg.com/news/marketsmag/ratings.html.

[57] *See* THOMSON REUTERS, DEBT CAPITAL MARKETS REVIEW, US INVESTMENT GRADE CORPORATE DEBT (F9) (Fourth Quarter 2007), *available at* http://online.thomsonreuters.com/DealsIntelligence/Content/Files/4Q07_Debt_Capital_Markets_R1.pdf (providing a total industry debt of $935,191,700,000 for 2006); THOMSON REUTERS, US PRIVATE PLACEMENTS REVIEW, PLAIN VANILLA DEBT EXCLUDING REG. S (AN 10) (Second Half 2007), *available at* http://online.thomsonreuters.com/DealsIntelligence/Content/Files/4Q07_Private_Placement.pdf (providing a total industry plain vanilla debt of $44,225,200,000 for 2006).