RETURN DATE: AUGUST 19, 2008

---X	SUPERIOR COURT
STATE OF CONNECTICUT :	
:	JUDICIAL DISTRICT OF HARTFORD
Plaintiff, :	AT HARTFORD
v. :	
:	
FITCH, INC. :	
:	
Defendant. :	JULY 30, 2008
---X	

COMPLAINT

I. SUMMARY OF THE CASE

1. This lawsuit seeks redress for Fitch, Inc.'s ("Fitch's") unfair, deceptive and illegal business practice of systematically and intentionally giving lower credit ratings to bonds issued by states, municipalities, and other public entities as compared to corporate and other forms of debt with similar or even worse rates of default.

2. This systematic underrating of bonds issued by states, municipalities, and other public entities has harmed these public bond issuers by forcing them to either purchase bond insurance to improve their credit rating or to pay higher interest costs on their lower rated bonds. These costs are ultimately borne by taxpayers and would be unnecessary if Fitch fairly and honestly rated public bonds according to the likelihood public bond issuers would pay back their bonds on time, which is what Fitch falsely represents its ratings measure.

3. Since 1999, Fitch's own credit studies have repeatedly concluded that many common types of public bonds almost never default. For example, a 1999 Fitch study concluded that this fact "strongly suggest[s] that there are several sectors of state and local government debt that are underrated compared to ... corporate debt" and that "many ratings in traditional general obligation and essential government enterprise sectors, such as water and

sewer utilities, are too low." These conclusions were confirmed by a 2003 Fitch study that concluded the default rates for "tax-backed, water/sewer, and other 'plain vanilla' municipal bonds is almost nil." Fitch's own conclusions were matched by similar studies done by the other two major credit rating agencies, S&P and Moody's. Fitch was fully aware of the S&P and Moody's studies.

4. Despite these unmistakable conclusions, Fitch took little action to rate public bonds according to what Fitch knew was their true credit risk. Thus, by August of 2006, one of Fitch's top municipal credit analysts was still able to report to Fitch's standard setting Credit Policy Board that "the persistent disparity in default rates provides persuasive evidence that Fitch-rated US municipal obligations are still underrated, relative to corporate securities."

5. Faced with its own repeated conclusions that public bonds were underrated, Fitch did nothing until May of 2007, when, rather than give public bonds the credit ratings Fitch knew they deserved, Fitch quietly changed its definition of what a public bond rating meant in order to justify continued low ratings. Despite the change in the meaning of its public bond ratings, Fitch continued to express its ratings using the very same letter grades ("AAA," "AA," "A") that Fitch had used before the change. Thus, a public bond receiving an "A" Fitch rating before the definition change still received the same "A" rating after the change, even though the "A" now supposedly meant something different.

6. Fitch chose to underrate public bonds not because it disbelieved its own data, but because Fitch concluded more proper ratings "runs counter to investor preferences" and because it was unclear whether rating public bonds according to their low default rates "would add value to [Fitch's] US public finance credit rating franchise." In other words,

Fitch was not concerned about what it knew to be a fair and accurate rating, it was concerned about whether use of that fair and accurate rating would be good for Fitch's bottom line.

7. The State of Connecticut and many of Connecticut's cities, towns, school districts, sewer and water districts, and other public entities hire and pay Fitch, according to Fitch's own representations, to provide a fair and honest "opinion on the ability of [the public bond issuer] to meet financial commitments, such as interest, preferred dividends, or repayment of principal, on a timely basis." Public bond issuers are entitled under the terms of their contracts with Fitch to exactly that service. By intentionally underrating public bonds, Fitch breached its contractual obligations and made material and intentional misrepresentations to the State of Connecticut and each of the Connecticut cities, towns, school districts and other public entities that hired Fitch to provide a credit rating.

8. Fitch's unfair, deceptive and illegal business practices have cost the State of Connecticut and many Connecticut cities, towns, school districts and other public entities millions of dollars in inflated interest payments and unnecessary bond insurance premiums. All of these costs are ultimately borne by Connecticut taxpayers.

9. For example, from 2003 through 2007, the City of Bridgeport issued ten general obligation bonds backed by the full faith and credit of the City of Bridgeport. From 2002 through 2007, the Town of Tolland issued six general obligation bonds backed by the full faith and credit of the Town of Tolland. Fitch gave each of Bridgeport's bonds an "A-" rating and each of Tolland's bonds either a "AA" or "AA-" credit rating. As a result of Fitch's deliberate underrating of public bonds, Bridgeport taxpayers paid a total of $2.7 million in unnecessary bond insurance premiums to receive a higher "AAA" rating from Fitch. Tolland taxpayers paid over $120,000 for their "AAA" bond insurer credit rating. What Fitch did not

tell the citizens of Bridgeport or Tolland, however, was that they were actually paying for a "AAA" rating from a bond insurer that Fitch's own credit studies concluded was far more likely to default than was either Bridgeport or Tolland.

10. Similarly, between 2002 and 2006, the Borough of Naugatuck issued five general obligation bonds backed by the full faith and credit of the Borough of Naugatuck. Fitch rated four of these bonds and gave each of the bonds it rated a "AA-" rating. As a result of Fitch's deliberate underrating of public bonds, Naugatuck taxpayers paid a total of over $31,000 in bond insurance premiums to receive the "AAA" rating from Fitch. What Fitch did not tell the citizens of Naugatuck, however, was that Fitch's own credit studies concluded that Naugatuck's bonds already had an essentially zero probability of defaulting and thus bond insurance was unnecessary.

11. Inflated interest costs and unnecessary bond insurance premiums would not be required of the State of Connecticut and the many Connecticut cities, towns, school districts and other public entities that hire Fitch, if Fitch would fairly and honestly rate the credit risk of these public entities in accordance with Fitch's own representations and conclusions and communicate that fair and honest rating to bond buyers in a non-deceptive manner.

12. In pursuing these unfair, deceptive and illegal business practices, Fitch violated the Connecticut Unfair Trade Practices Act. Pursuant to Conn. Gen. Stat. § 42-110m, the Connecticut Attorney General, in the name of the State of Connecticut, seeks restitution, disgorgement, and civil penalties for the injuries suffered by the State of Connecticut and all issuers of public debt in Connecticut, as well as other injunctive and equitable relief to prevent these unfair, deceptive and illegal business practices from continuing.

II. PARTIES

13. Plaintiff State of Connecticut, represented by Richard Blumenthal, Attorney General of the State of Connecticut, brings this action in its sovereign enforcement capacity pursuant to Conn. Gen. Stat. § 42-110m at the request of Jerry Farrell, Jr., Commissioner of the Department of Consumer Protection for the State of Connecticut.

14. Defendant Fitch, Inc. a/k/a Fitch Ratings ("Fitch") is a credit rating agency. Fitch employs over 2,100 credit analysts and has 49 offices worldwide. Fitch provides credit ratings on 94,000 public finance bonds throughout the United States.

15. Fitch is incorporated under the laws of the State of Delaware. Fitch maintains an office and principal place of business at One State Street Plaza, New York, New York.

16. Fitch regularly does business in the State of Connecticut and derives substantial revenue from its business within the State of Connecticut. From 1998 through 2008, Fitch provided over 150 ratings to at least 30 Connecticut cities and towns. Fitch also rates the many public bonds issued by the State of Connecticut. Since 2004, Fitch has taken in over $100 million in revenue for its rating of public bonds.

III. THE MUNICIPAL BOND MARKET

17. The municipal bond market consists of the issuers who issue public bonds and the buyers who purchase public bonds. Issuers of public bonds are states, like Connecticut, as well as large cities, small towns, school districts, sewer districts, housing authorities, airport authorities and many other publicly chartered or public purpose entities. Buyers of public bonds are banks or other lenders that buy a bond when it is first issued, as well as many individual and institutional investors that trade or sell public bonds in the secondary bond market.

18. A public bond is simply a loan to a public entity. Public entities issue bonds to raise funds to pay for a variety of essential government functions like construction or improvement of schools, roads, sewer and water systems, airports and other public projects and financial needs. Just like other loans, the cost of paying back the principal and interest on a public bond is paid for by the public entity that issued the bond. That means states, municipalities, school districts, sewer districts and other public entities pay back the principal and interest on the bond in accordance with a schedule set out in the bond. These costs are ultimately borne by taxpayers in the form of taxes and fees.

19. Once a bond is issued, it may be held by the buyer (usually a bank or other lender) who made the original loan, or the bond may be sold into the secondary market. Both the original buyer and any subsequent buyers in the secondary market, buy and sell public bonds depending in material part on the risk that the issuer will not pay back the bond.

20. A buyer of a bond will charge a higher interest rate on the bond the more likely it is that the bond issuer will not be able to pay back the loan. A higher interest rate compensates the buyer for the higher risk it undertakes in making a more risky loan.

21. A critical and material part of a buyer's assessment of the risk that a bond will not be paid back, and therefore the interest rate the buyer will charge the issuer for the loan, is the bond's credit rating. Fitch is well aware of this fact. As Fitch has stated in its rating definitions for the last 10 years, "credit ratings are used by investors as indications of the likelihood of receiving their money back in accordance with the terms on which they invested." There are many bond buyers in Connecticut, including, *inter alia*, banks, insurance companies, hedge funds and individuals.

22. The credit rating market is extremely concentrated. The three major credit rating agencies, Fitch, Standard & Poor's ("S&P"), and Moody's Corporation ("Moody's"), together issue credit ratings on essentially 100% of the public bonds issued in the United States.

23. Failure to receive a credit rating from one or more of the three major credit rating agencies typically leads to a public bond receiving either a very high interest rate or not being bought at all. Therefore, most public bond issuers are forced to seek a credit rating from one or more of the three major credit rating agencies in order to issue their public bonds at some reasonable interest rate.

24. Fitch is well aware that public bonds are extremely safe investments. A 1999 Fitch credit study found that the cumulative default rate for all public bonds issued from 1979-1986 was just 1.49%, and for the safest kinds of municipal bonds – general obligation, taxed backed, and essential service bonds – the default rate was "almost nil" at 0.26%.

25. A 2003 Fitch credit study confirmed the 1999 study results, concluding that despite the economic downturn of 2001 through 2003, Fitch found "no meaningful changes in municipal default risk, which is still very low." A 2007 Fitch report stated that "from 1987-2002, the five-to-15 year cumulative default rates [for general obligation, tax backed and essential service bonds] average 0.24%, which is less than the 10-year cumulative default rate of 0.43% for 'AAA' rated global corporate bonds." In other words, most public bonds – regardless of rating – default at <u>half the rate</u> of corporate "AAA" bonds.

26. Public bonds rarely default because of the fundamental nature of governments. Governments typically have broad taxing power that ensure they can meet their bond payments. Governments are not subject to economic competition as are businesses.

Governments do not go out of business and frequently are legally prohibited from filing for bankruptcy. Moreover, many cities, towns, and other public entities effectively are supported by higher levels of government that can and do provide necessary funding to prevent defaults. These facts are known to Fitch and are reflected in Fitch's credit studies.

27. From 1998 to 2008, the State of Connecticut issued multiple bonds totaling over $15 billion. From 1998 to 2008, at least one hundred Connecticut cities and towns issued over $8 billion in bonds to pay for the kinds of necessary government projects described above.

28. Despite never having defaulted on any bond obligation, the State of Connecticut has been rated in the "AA" range by Fitch for many years. Most Connecticut municipalities have also been rated by Fitch in the "AA" and "A" range, even though no Connecticut municipalities have defaulted on a bond obligation and would likely be rated "AAA" if judged on the same scale as corporate bonds with equal probabilities of default.

29. Approximately 50% of the buyers in the public bond markets are individual investors and consumers. In many cases, individual buyers are less sophisticated than institutional buyers like investment banks or mutual fund companies. Institutional buyers frequently have the resources to do their own credit analysis on a bond. Individual buyers frequently do not have either the resources or expertise to do their own credit analysis on a bond.

30. Individual public bond buyers rely heavily on the credit ratings provided by Fitch and the other credit rating agencies when making a decision to purchase a public bond. Indeed, Fitch's credit rating of a public bond is a significant and material factor in any bond buyer's decision whether to buy a public bond and what price to pay for that bond. Fitch is

aware of public bond buyers' use and reliance on Fitch's credit ratings.

IV. FITCH'S ROLE IN THE MUNICIPAL BOND MARKET

31. Fitch represents that its credit ratings provide a fair and honest opinion of the likelihood that a public bond will be paid back according to its terms and the default risk of a given public bond. For example, from 1999 through May of 2007, Fitch represented in its ratings definitions that "Fitch's credit ratings provide an opinion on the relative ability of an entity to meet financial commitments, such as interest, preferred dividends, or repayment of principal, on a timely basis." Similarly Fitch's 1999 credit study represented that "credit ratings are assigned to debt securities as an indicator of default probability."

32. To provide its credit ratings, Fitch charges the issuer a fee based on the size and complexity of the bond being issued. In return for the fee paid by the issuer, Fitch provides the issuer with a letter grade credit rating and makes that letter grade credit rating available to the public on its website.

33. Fitch represents to public bond issuers that its public bond credit ratings will be based on an analysis of facts. Before Fitch issues a credit rating, it meets with a public issuer to gather information on the issuer's financial status. Fitch discusses any questions it might have with employees of the issuer and allows the issuer to ask Fitch analysts questions. Fitch issues ratings through a credit committee that discusses the individual merits of an issuer's credit profile and reaches a consensus on an appropriate rating. Fitch provides an appeals process if the issuer believes Fitch's credit rating is wrong.

34. Fitch's credit ratings, like the other major credit rating agencies, have long been expressed in the form of a letter grade. According to its rating definitions, Fitch's letter grades are expressed in relative rank order, with a bond rated "AAA" represented to have the

"highest credit quality" and an "exceptionally strong capacity for timely payment of financial commitments." Bonds rated "AA," "A," "BBB," "BB," "B," "CCC," "CC," and "C" are represented by Fitch to have progressively more risk of nonpayment with each succeeding reduction in grade level. Thus, when a bond receives Fitch's lowest "C" rating, that means "default is imminent."

35. Through its relative letter ranking system, Fitch intentionally represents that bonds rated "AAA" have less chance of nonpayment than bonds rated "AA," that bonds rated "AA" have less chance of nonpayment than bonds rated "A," and so on down Fitch's rating scale.

36. A public bond issuer will often obtain ratings from two or three of the different credit rating agencies. The ratings of the three credit agencies generally correlate with each other, such that a bond rated "AAA" by Fitch will typically carry an identical or very similar rating by S&P and Moody's.

37. A bond's letter grade credit rating has a significant impact on the interest rate paid by the issuer to the buyer. Thus, a bond rated "AAA" by Fitch generally carries a lower interest rate than the same or similar bond rated "AA" by Fitch. A bond rated "AA" by Fitch generally carries a lower interest rate than the same or similar bond rated "A" by Fitch, and so on down Fitch's letter rating scale. This means that a state, city, town, school district or other public bond issuer that issues a bond rated "A" by Fitch will generally pay a higher interest rate and higher debt service costs than the same or similar bond rated "AAA" by Fitch.

38. To avoid the higher cost of a higher interest rate, public issuers rated below "AAA" by Fitch can improve the rating their bonds receive by purchasing insurance from one of the major bond insurance companies, such as MBIA or Ambac. In deciding whether to

purchase bond insurance, states, including Connecticut, and other public issuers, including Connecticut cities and towns, rely on Fitch's representation that a public bond issuer with a lower credit rating has a greater likelihood of not paying its bond than a bond insurer with a higher credit rating. Approximately half the public bonds issued are issued with bond insurance.

39. Bond insurers guarantee the repayment of the bond in the rare event that a state, town, or school district defaults on its bonds. Because until very recently most major bond insurers were given "AAA" credit ratings by Fitch, the practical effect of a public issuer purchasing bond insurance was to transfer the bond insurer's "AAA" credit rating to the public issuer's bond. Thus, if a public issuer received an "A" credit rating from Fitch, that issuer might purchase bond insurance and thereby improve the credit rating of its bond to "AAA." This increase would allow the public issuer's bond to receive the lower interest rate associated with a "AAA" credit rating, but with the added cost of the bond insurance premium. Fitch is aware of this process and the essential part its credit ratings play in the process.

40. Because of the direct effect of Fitch's credit rating on the interest rate charged on public bonds, it is critical that bond insurers receive a "AAA" rating from Fitch. Indeed, a 2007 Fitch studied acknowledged that a bond insurer's credit rating is "core to their franchise value." If a bond insurer's credit rating drops below "AAA," many public bond issuers would receive little or no benefit from purchasing bond insurance because the bond insurer's credit rating would be little or no better than the issuer's own credit rating. Bond insurers' use of their credit ratings to sell their insurance helps perpetuate and elevate the importance of Fitch's credit ratings in the bond market.

41. What Fitch did not tell many public bond issuers or buyers, however, was that Fitch knew the bond insurers' true credit risk was already no better, or, in many cases, worse than the public issuer purchasing bond insurance.

42. Unlike states, towns, and other public bond issuers, Fitch rates bond insurers relative to other corporations. As Fitch's credit studies have repeatedly confirmed, corporations have much higher rates of default than public issuers with similar credit ratings. Therefore, when a public bond issuer purchased a bond insurer's "AAA" credit rating, the public issuer was in many cases purchasing a credit rating that, according to Fitch's 2007 study, carried a risk of default <u>two times worse</u> than the average general obligation or essential service bond issued by a state, city or town.

43. Making matters more harmful and unfair still is how Fitch calculated the credit risk associated with bond insurers. A key component of a bond insurer's credit rating is Fitch's assessment of the bond insurer's ability to pay claims on defaulted bonds. A key component in assessing a bond insurer's ability to pay claims is Fitch's assumption of how often public bonds will default, thus requiring a payment by the bond insurer.

44. When assuming how often public bonds will default to assess a bond insurer's ability to pay claims, Fitch did not assume that public bonds would default at the higher rates typical of the credit ratings that public bonds were receiving from Fitch. Instead, Fitch assumed public bonds would default near the far lower rates found in its credit studies. As stated in a Fitch report describing Fitch's bond insurer capital adequacy model: "The model uses the assumption that [general obligation and taxed backed public bonds] will default at a rate similar to corporate bonds rated one full [ratings] category higher." Thus, not only did Fitch intentionally refuse to give public bonds credit ratings that were equal to what

Fitch knew to be their true risk of default, but Fitch turned around and gave the benefit of that good credit history to the bond insurers seeking to sell insurance to the very same public issuers. The direct effect of this Fitch policy, as Fitch well knew, was to artificially depress public bond ratings, artificially increase bond insurer ratings, and thereby artificially increase the market for bond insurance.

45. The link between lower public bond issuer credit ratings and a bigger public bond insurance market was long recognized by Fitch. A November 1999 Fitch study on the bond insurance market concluded that Fitch's September 1999 municipal default rate study "suggests that overall municipal bond ratings will likely go up in the future, potentially reducing the value added by bond insurance in some municipal sectors."

46. Put simply, Fitch intentionally and unfairly gave the benefit of public bond issuers' good credit history to the bond insurers knowing full well that the bond insurers were going to turn around and effectively sell that good credit history back to the public bond issuers for the price of the insurance premium.

V. FITCH INTENTIONALLY UNDERRATES PUBLIC BONDS

47. For nearly a decade, Fitch has known that it underrates public bonds as compared to corporate bonds and that this policy costs public bond issuers money in the form of higher interest costs or unnecessary bond insurance costs. Despite knowing these facts, Fitch continues to represent that public bond issuers with lower credit ratings have a greater likelihood of not paying their bonds than a bond insurer or corporate bond issuer with a higher credit rating. These knowingly false representations harm public bond issuers when they buy bond insurance based on their own ratings and bond buyers who consider Fitch's credit rating when deciding to purchase public bonds.

48. In September of 1999, Fitch published a comprehensive study of the default rates of all public bonds issued since 1980. The study concluded that public debt is "generally regarded as low risk" and that the "Fitch [] study of municipal default rates bears this out."

49. In November of 1999, Fitch issued a study of the bond insurance market that again acknowledged that many common public bonds – general obligation, tax backed, water/sewer, transportation, and education bonds – have "extremely low default rates."

50. In March of 2000, Fitch issued a report on "Credit Ratings in the 21st Century" which stated that Fitch's 1999 study "strongly suggest[s] that there are several sectors of state and local government debt that are underrated compared to … corporate debt" and that "many ratings in traditional general obligation and essential government enterprise sectors, such as water and sewer utilities, are too low." The report went on to state that "… the debt ratings on traditional governmental units and enterprises understate their inherent safety, which is Fitch['s] contention after its default study." The March 2000 report concluded that there was a "need for upgrades to more accurately reflect the low risk of traditional municipal debt."

51. A second important conclusion of the March 2000 Fitch Report was that "it appears that rating agencies have historically rated smaller [public] issuers too low." A subsequent report issued by Fitch in May of 2000 bolstered that conclusion. "Default experience and case studies do not indicate a strong correlation between an issuer's size and default frequency. However, traditional analysis tends to reward size because of the depth of the economy and the diversity of revenues that accompany larger governments…. Fitch['s] default study provided no strong evidence that units with lower than average income levels had higher rates of default."

52. In May of 2000 Fitch gave some "slight" upgrades to some general obligation and essential service public bonds. Fitch recognized that with these upgrades "issuers will assume more appropriate borrowing costs, and investors will receive fair returns commensurate with risk."

53. From 2002-2003, despite the conclusions of its two previous public bond default studies, Fitch nevertheless downgraded some 210 public issuers because of concerns over terrorism, economic recession, Severe Acute Respiratory Syndrome (SARS), and high profile corporate defaults like Enron and Worldcom. From 2002-2003, there was in fact no increase in the low levels of public defaults because the fundamental credit stability of public bond issuers had not changed.

54. In November of 2002 another major ratings service, Moody's, published a study examining the default rate of some 82,000 bonds issued by some 29,000 public issuers from 1970-2000. Like Fitch, the Moody's 2002 study concluded that public bonds had very low default rates. The Moody's study found that the average default rate for all Moody's rated bonds (even including those public bonds in more risky classes) was still less than AAA rated corporate bonds. Fitch was aware of the Moody's 2002 study.

55. In March of 2003, Fitch's Credit Policy Board (CPB), the body within Fitch that considers and makes decisions on its ratings methodologies and procedures, discussed the Moody's study and the fact that "Fitch's own municipal default study reached the same conclusion" that "the default risk on a US municipal bond was lower than on a US corporate bond." The CPB considered issuing a public statement acknowledging that "there in fact does seem to still be an inequality of risk in similarly rated corporate and municipal credits," but, in the end, decided to just study the issue again.

56. In June of 2003, Fitch issued its second report on public bond default rates. The 2003 report found "no meaningful changes in the overall municipal default risk, which is still very low . . ." and that the default rates for "tax-backed, water/sewer, and other 'plain vanilla' municipal bonds is almost nil." The 2003 Fitch study also found that even in the rare instance that a public bond did default, bondholders still got 67% of their money back.

57. Despite the clear findings of Fitch's 2003 study, Fitch took no action to upgrade public bonds to properly reflect the study's results and what Fitch knew to be public bonds' true credit risk. In fact, during the first half of 2004, Fitch downgraded nearly as many public bond issuers (11) as it upgraded (18).

58. In August of 2006 – three years after the findings of Fitch's 2003 study and seven years after its 1999 study – Fitch's CPB considered whether to issue public bond ratings that would rate public bonds on the same scale as corporate bonds. By this time, Fitch was aware that Moody's was offering so-called "Corporate Equivalent Ratings" for a limited class of public bonds and that a 2002 Moody's study had concluded that public bonds rated by Moody's were five times less likely to default than Moody's highest rated "Aaa" corporate bonds. Fitch was also aware at this time that the third major credit rating agency, S&P, had issued at least five default studies confirming the low default rates of public bonds as compared to corporate bonds.

59. In considering during the summer of 2006 whether to offer public bond ratings that were equal to corporate bond ratings, one of Fitch's top municipal credit analysts reported to Fitch's CPB that:

> the persistent disparity in default rates provides persuasive evidence that Fitch-rated US municipal obligations are still underrated, relative to corporate securities. We have in fact adjusted for this risk differential in Fitch's new financial guarantee capital model. The problem with upgrading most US

> municipal bond ratings further is that it would mean compressing most of our US public finance ratings into the 'AAA' and 'AA' categories. This runs counter to investor preferences .... It is also unclear if the expanded use of corporate equivalent ratings would add value to the US public finance credit rating franchise. We should poll European and US taxable bond investors ... as to their thoughts on this potential product.

60. In other words, Fitch was not concerned with issuing credit ratings that, as Fitch represented in 1999, are "assigned to debt securities as an indicator of default probability," or, as Fitch's definition of its own ratings represented in 2006, "are opinions reflecting the ability of an entity ... to meet financial commitments ... in accordance with their terms." Instead, Fitch was concerned with providing a rating that provided enough differentiation among public bonds to allow bond buyers to trade public bonds back and forth and with maintaining the importance and marketability of Fitch's own ratings product.

61. Missing from Fitch's list of issues to consider was whether or not rating public bonds in accordance with the default rates shown in Fitch's own default studies would in fact provide an accurate assessment of a public issuer's ability to pay back a bond according to its terms. Fitch's studies had of course concluded since 1999 that such ratings would accurately reflect a public bond issuer's true credit risk.

62. Not unsurprisingly, in August of 2006, Fitch decided not to offer public bond ratings that were equal to corporate bond ratings.

63. In January of 2007, Fitch's again considered whether to offer public bond ratings that were equal to corporate bond ratings. In a draft internal document outlining why such ratings should be issued, one of Fitch's top public bond analysts wrote: [Fitch has] concluded from two comprehensive municipal default studies that most US public finance sectors have lower default risk and higher recovery prospects tha[n] similarly rated corporate debt." The same Fitch analyst continued that "[m]unicipal ratings are a measure of credit

quality.... They do not necessarily provide an apples-to-apples comparison of default risk or expected loss between sectors.... In terms of expected loss on municipal bonds, an A is not an A is not an A." This Fitch statement was never made public.

64. In March of 2007, Fitch continued its internal debate over whether to offer public bonds ratings equal to corporate bond ratings. A Fitch memo advocating that change stated that the low default and loss rates of public bonds "spoke to the need to rethink municipal ratings" and recommended a rating scale as much as three Fitch notches higher for many public bonds. Again, these Fitch conclusions were not made public and Fitch continued to represent that its public bond ratings were comparable to corporate bond ratings.

65. In January and March of 2007, Fitch's official definition of its credit ratings stated that "Fitch's credit ratings provide an opinion on the relative ability of an entity to meet financial commitments..." and that Fitch's letter grades reflected Fitch's assessment of an issuer's "capacity for payment of financial commitments." Fitch's official definitions said nothing about Fitch changing its assessment of a public issuer's "capacity for payment of financial commitments," if Fitch's opinion had the effect of "compressing most of our US public finance ratings," or failed to "add value to [Fitch's] US public finance credit rating franchise," or ran "counter to investor preferences," or was not marketable to "European and US taxable bond investors."

66. In March of 2007, Fitch rejected the idea of offering public bond ratings that were equal to corporate bond ratings. Instead, Fitch began considering simply changing its public bond ratings definition and, for the first time since at least 1999, publicly stating what its public bond ratings really meant.

67. On the evening of May 30, 2007 – nearly 8 years after first concluding that "several sectors of state and local government debt are underrated compared to … corporate debt" and that "many ratings in traditional general obligation and essential government enterprise sectors, such as water and sewer utilities, are too low" – Fitch quietly changed its website. In its new posting, Fitch added a single sentence to its ratings definitions, noting that "U.S. public finance debt securities measure credit quality relative of other U.S. public finance debt securities."

68. Fitch did not issue a press release and issued no report on this fundamental and significant change in the definition of its public bond rating. Indeed, Fitch did not change its official rating definitions until August of 2007, and then noted the critical change in definition in a footnote.

69. By the fall of 2007, Fitch had entirely dropped the idea of offering public bond ratings that were equal to corporate bond ratings. By that time, the U.S. credit markets were in the middle of an historic credit crisis and Fitch and the other major rating agencies were under heavy criticism for rating many subprime structured bonds too highly. Despite nearly 8 years of studies and internal discussions showing beyond any doubt that public bonds were underrated compared to corporate bonds, Fitch continued to give public bonds the same low ratings it had always given. As one Fitch employee wrote in dismissing the problem, "given the current state of the credit markets, no one is complaining that our municipal rating are too low."

70. Fitch continues to this day to systematically and intentionally give lower credit ratings to the bonds issued by states, municipalities, and other public entities as compared to corporate and other forms of debt with similar or even worse rates of default.

VI. CAUSES OF ACTION

First Count: *Breach of the Connecticut Unfair Trade Practices Act* (Conn. Gen. Stat. § 42-110a et seq.)

1-70. Paragraphs 1 through 70 of the Complaint are hereby repeated and realleged as Paragraphs 1 through 70 of this First Count as if fully set forth herein.

71. The State of Connecticut and many of Connecticut's cities, towns, school districts, sewer and water districts, and other public entities (hereinafter "Connecticut public bond issuers") issue public bonds on a reoccurring basis.

72. Fitch was hired by Connecticut public bond issuers to provide ratings on their many bonds.

73. Each time a Connecticut public bond issuers issued a public bond, the Connecticut public bond issuer hired Fitch to provide Fitch's fair and honest opinion of that Connecticut public bond issuer's ability to meet its financial commitments under the bond on a timely basis and in accordance with the terms of the bond.

74. Connecticut public bond issuers did not hire Fitch to change its fair and honest opinion of Connecticut public bond issuers' ability to pay back their bonds depending on how Fitch's fair and honest opinion might lead to "ratings compression," might not be in accord with investor preferences, might harm the bond insurance market, or might not add value to Fitch's ratings franchise.

75. Each time Connecticut public bond issuers issued a public bond, Connecticut public bond issuers paid Fitch a fee to provide a credit rating.

76. Each time Connecticut public bond issuers issued public bonds, Fitch failed to provide Connecticut public bond issuers with Fitch's fair and honest opinion of Connecticut

public bond issuers' ability to meet their financial commitments under their bonds on a timely basis and in accordance with the terms of their bonds.

77. Connecticut public bond issuers had a reasonable expectation that they would receive the benefits of their agreements with Fitch, including, but not limited to, Fitch's fair and honest opinion of Connecticut public bond issuers' ability to meet their financial commitments under their bonds on a timely basis and in accordance with the terms of their bonds.

78. As a result of its systematic underrating of public bonds as alleged above, Fitch injured Connecticut public bond issuers' right to receive the economic benefits of their agreements with Fitch, including, but not limited to, a credit rating and interest rate on the Connecticut public bond issuers' public bonds commensurate with their true ability to pay back their bonds.

79. Fitch acted in bad faith, with dishonest purpose, and evaded the purpose and spirit of its agreements with Connecticut public bond issuers when Fitch, *inter alia*, issued credit ratings that it knew did not accurately reflect Fitch's fair and honest opinion of Connecticut public bond issuers' ability to meet their financial commitments under their bonds on a timely basis and in accordance with the terms of their bonds.

80. Fitch intentionally and knowingly represented to Connecticut public bond issuers that Fitch's ratings were based on Fitch's fair and honest opinion of Connecticut public bond issuers' ability to meet their financial commitments under their bonds on a timely basis and in accordance with the terms of their bonds.

81. Fitch intentionally and knowingly represented to Connecticut public bond issuers that a public bond issuer with a lower Fitch credit rating has a greater likelihood of not paying its bond than a bond insurer with a higher credit rating.

82. Fitch knew that the foregoing material representations were false and/or Fitch acted with reckless disregard for the truth in making the foregoing representation. Fitch made these false representations with the intent that Connecticut public bond issuers would rely on Fitch's false representations, *inter alia*, in deciding to contract with Fitch to receive a credit rating, in issuing Connecticut public bond issuers' bonds, in accepting buyer bids to purchase Connecticut public bond issuers' bonds, and in deciding to purchase bond insurance.

83. Connecticut public bond issuers reasonably interpreted and relied on Fitch's foregoing material representations.

84. At all times relevant to this Complaint Fitch was engaged in the trade or commerce of providing credit ratings within the State of Connecticut.

85. By engaging in the acts and practices alleged herein, Fitch made or caused to be made to Connecticut consumers, directly or indirectly, explicitly or by implication, representations which are material, reasonably interpreted, false and likely to mislead, including, but not limited to, the following:

a. that Fitch's credit ratings were Fitch's fair and honest opinion on a public bond issuer's ability to meet its financial commitments under the bond on a timely basis and in accordance with the terms of the bond;

b. that Fitch's public bond ratings were comparable to Fitch's corporate bond ratings;

c. that Fitch's public bond ratings were based on the same ratings scale as Fitch's corporate bond ratings; and

d. that bond insurers rated "AAA" by Fitch were a better credit risk than public bond issuers with lower Fitch credit ratings.

86. By engaging in the acts and practices alleged herein, Fitch made omissions to Connecticut consumers that Fitch had a duty to disclose by virtue of Fitch's contractual obligations to Connecticut consumers and its other representations to Connecticut consumers, including, but not limited to, the following:

a. that Fitch's credit ratings were not Fitch's fair and honest opinion on a public bond issuer's ability to meet its financial commitments under the bond on a timely basis and in accordance with the terms of the bond;

b. that Fitch's public bond ratings were not comparable to Fitch's corporate bond ratings;

c. that Fitch's public bond ratings were not based on the same ratings scale as Fitch's corporate bond ratings;

d. that Fitch's public bond ratings were based in part on a desire to avoid ratings compression;

e. that Fitch's public bond ratings were based in part on the preferences of investors and other market participants;

f. that Fitch's public bond ratings were based in part on a desire to promote Fitch's economic interests; and

g. prior to January of 2007, that Fitch allowed bond insurers to take advantage of public bond issuers' low default rates, while Fitch

simultaneously denied public bond issuers the benefit of their own low default rates, thus knowingly allowing bond insurers to sell more bond insurance to public issuers.

87 Fitch's acts and practices regarding Connecticut consumers as alleged herein are unfair, oppressive or unscrupulous and violated the public policy of the State of Connecticut, including, but not limited to the public policy against:

a. misrepresenting the nature and extent of your services in business;

b. labeling products in a misleading and confusing manner;

c. parties breaching their contractual obligations;

d. contract parties breaching the duty of good faith and fair dealing; and

e wasting public assets.

88. Fitch's acts and practices as alleged herein have been and are unethical, oppressive and unscrupulous, and cause substantial injury.

89. Fitch's knew or should have known that their conduct alleged herein violated Conn. Gen. Stat. § 42-110b.

90. Fitch's acts and practices as alleged herein have directly and proximately caused substantial injury to consumers within the State of Connecticut.

91. Fitch's acts or practices alleged herein constitute unfair or deceptive acts or practices in violation of Conn. Gen. Stat. § 42-110b.

PRAYER FOR RELIEF

WHEREFORE, the State of Connecticut requests the following relief:

1. A finding that by the acts alleged herein, Fitch engaged in unfair and deceptive acts and practices in the course of trade or commerce within the State of Connecticut in violation of the Connecticut Unfair Trade Practices Act;

2. An injunction pursuant to Conn. Gen. Stat. § 42-110m enjoining Fitch from engaging in any acts that violate the Connecticut Unfair Trade Practices Act, including, but not limited to, the unfair and deceptive acts and practices alleged herein;

3. An order pursuant to Conn. Gen. Stat. § 42-110m requiring that Fitch submit to an accounting to determine:

   a. the amount of improper fees and revenue paid to Fitch as a result of its unfair and deceptive acts and practices as alleged herein;

   b. the amount Fitch's unfair and deceptive acts and practices improperly increased borrowing costs for public bond issuers in Connecticut.

4. An order pursuant to Conn. Gen. Stat. § 42-110o directing Fitch to pay a civil penalty of $5,000 for each and every willful violation of the Connecticut Unfair Trade Practices Act;

5. An order pursuant to Conn. Gen. Stat. § 42-110m directing Fitch to pay restitution;

6. An order pursuant to Conn. Gen. Stat. § 42-110m directing Fitch to disgorge all revenues, profits, and gains achieved in whole or in part through the unfair acts or practices complained of herein;

7. An order pursuant to Conn. Gen. Stat. § 42-110m directing Fitch to pay reasonable attorneys' fees to the State;

8. Costs of suit; and

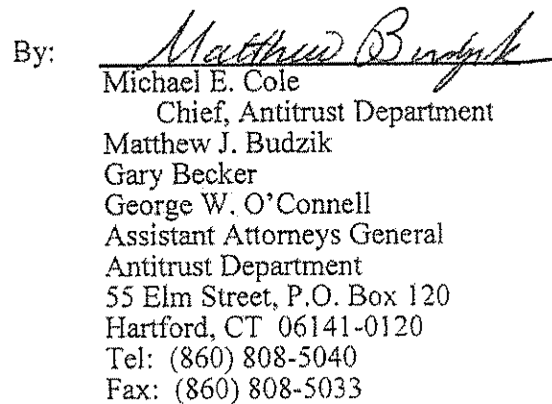
9. Such other relief as this Court deems just and equitable.

Plaintiff State of Connecticut hereby demands a trial by jury on all issues and causes of action so triable.

Dated at Hartford, Connecticut, this 30th day of July, 2008.

PLAINTIFF
STATE OF CONNECTICUT

By:
RICHARD BLUMENTHAL
ATTORNEY GENERAL

By: 

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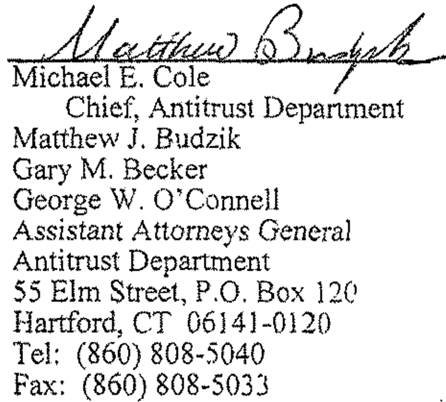
RETURN DATE: AUGUST 19, 2008

--X	SUPERIOR COURT
STATE OF CONNECTICUT :	
:	JUDICIAL DISTRICT OF HARTFORD
Plaintiff, :	AT HARTFORD
v. :	
:	
FITCH, INC. :	
:	
Defendant. :	JULY 30, 2008
--X	

AMOUNT IN DEMAND

The amount, legal interest or property in demand is $15,000.00 or more, exclusive of interest and costs.

PLAINTIFF
STATE OF CONNECTICUT

BY: 

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