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MEMORANDUM

To: Affiliated Persons Holding 'Class A' Non-Voting L.L.C. Membership Interests
Aspen Associates, L.L.C. (NV), Designated Beneficiary, Starwood Creditor Trust

From: Kevin O'Brien, President
Sovereign Advisers, Inc., Creditor Trustee, Starwood Trust, an Arizona Grantor Trust

Date: March 9, 2007

Re: **Judicial Recovery of Defaulted Creditors' Claims** *(click on link to view template)*

1. Termination of preferential payments by the government of China to selected members of its general obligation sovereign creditors; discussion of *pari passu* principle; petition for pre-judgment injunction restraining or intercepting non-proportional discriminatory payments; and
2. Development of parallel civil actions for recovery of repayment and damages.

This Memorandum examines certain issues involved in restraining preferential and discriminatory payments to selected creditors of the government of China and posits a theory upon which to sustain a pre-judgment *ex parte* petition for a restraining order effectively enjoining preferential payments on the Chinese government's selectively honored sovereign obligations including those which appear in Exhibit 1, captioned "Debt Table", and in particular the following payments:

1. The April 28th and October 28th payments to European holders of the Chinese government's 3.75% Notes due 2009 (ISIN XS0203592422). The designated paying agent responsible for processing this payment is JPMorgan Chase Bank Luxembourg S.A.;

2. The May 23rd payment to European holders of the Chinese government's sovereign obligations due 2011 (ISIN XS0129936331);

3. The April 29th and October 29th payments to European holders of the Chinese government's sovereign obligations due 2013 (ISIN XS0178312913);

4. The April 29th and October 29th payments to European holders of the Chinese government's 4.75% Notes due 2013 (ISIN US712219AJ30). The designated paying agent responsible for processing this payment is JPMorgan Chase Bank Luxembourg S.A.;

5. The October 28th payment to European holders of the Chinese government's 4.25% Bonds due 2014 (ISIN XS0203685788). The designated paying agent responsible for processing this payment is JPMorgan Chase Bank Luxembourg S.A.; and

6. The April 28th and October 28th payments to European holders of the Chinese government's sovereign obligations due 2027 (ISIN US712219AG90).

Chinese Government's Recently Issued Sovereign Debt

The following chart presents a summary of the Chinese government's outstanding foreign-issued sovereign bonds:

Exhibit 1

Debt Table
Government of China
Rated General Obligation Foreign Currency Sovereign Debt [1]

Issuance / Maturity Dates	Payment Date(s)	Currency	Total Amount	ISIN	Luxembourg Exchange Listed
Due 2008	See Addendum	USD	1,000,000,000	US712219AH73	Yes
3.75% Notes Due 2009 **Paying Agent:** JPMorgan Chase Bank Luxembourg S.A.	April 28 / Oct. 28	USD	500,000,000	XS0203592422	Yes
Due 2011	May 23	USD	1,000,000,000	XS0129936331	Yes
Due 2013	April 29 / Oct. 29	USD	1,000,000,000	XS0178312913	Yes
4.75% Notes Due 2013 **Paying Agent:** JPMorgan Chase Bank Luxembourg S.A.	April 29 / Oct. 29	USD	1,000,000,000	US712219AJ30	Yes
4.25% Bonds Due 2014 **Paying Agent:** JPMorgan Chase Bank Luxembourg S.A.	Oct. 28	Euro	1,000,000,000	XS0203685788	Yes
Due 2015	See Addendum	Yen	10,000,000,000	JP515600ARC9	No
Due 2027	April 28 / Oct. 28	USD	100,000,000	US712219AG90	Yes
Due 2096	See Addendum	USD	100,000,000	US712219AC86	No

Pre-Judgment Petition for Injunction Restraining Discriminatory Payments

The standard applied by the Belgian Commercial Court as respects a decision granting a petition for a preliminary injunction restraining exclusionary payments may be said to approximate the U.S. standard. Accordingly, in order to successfully establish an entitlement to this relief the plaintiff must (i) demonstrate that in the absence of its issuance the plaintiff will suffer irreparable harm, and (ii) convincingly demonstrate that the plaintiff is likely to prevail on the merits.[2]

[1] Note that the information presented in the Debt Table excludes the government of China's pre-1949 defaulted sovereign debt which remains an unpaid obligation of the Chinese government. For a listing of the defaulted sovereign obligations of the government of China, refer to the schedule detailing the defaulted sovereign debt of the Chinese government prepared by the U.S. Foreign Bondholders Protective Council for the period of 1965-1967 (copy attached). The information appearing in the Debt Table presented herein is obtained from the following two primary sources:
Fitch Ratings website: *http://www.fitchratings.com*
Luxembourg Bourse website: *http://www.bourse.lu*

[2] See Doran v. Salem Inn, Inc., 422 U.S. 922, 931 (1975). See also, Saftey-Kleen, Inc. (Pinewood) v. Wyche, 274 F.3d 846, 868 (4th Cir. 2001): *"The Supreme Court has consistently applied the four-part test*

Pari Passu Principle

When applied to inter-creditor proceedings, the established legal principle of *pari passu* provides that all participants comprising a class of creditors shall be entitled to participate equally in stature and without preference.[3] The *pari passu* principle has been interpreted, in a recent and celebrated decision by the Court of Appeals of Brussels, to include the prohibition of preferential payments to selected parties comprising a class of foreign senior general obligation creditors. The Court's decision (described at length below) establishes a judicial precedent that all creditors comprising a specific class are entitled to participate pro rata in any payment(s) made by the debtor and which payment(s) constitute an amount less than the total amount collectively due.

This general principle, in conjunction with the interpretative precedent obtained by Elliott Associates, may act as a basis for requesting a restraining order from the Belgian Commercial Court to prevent China's paying agent(s) from making preferential payment(s) to European holders of China's sovereign obligations.

Elliott Associates

Elliott Associates ("Elliott"), a private U.S. investment firm, sought to enforce a judgment awarded by the United States Court of Appeals for the Second Circuit against the government of Peru.[4] In pursuit of this objective and on the basis of a *pari passu* clause contained in the debt contract, Elliott filed a petition with the Belgian Commercial Court for a grant of injunction preventing any payment by the government of Peru to its other senior, unsecured general obligation creditors.[5] The Court granted Elliott an *ex parte* hearing, after which the Court denied Elliott's petition. Elliott then appealed the decision to the Court of Appeals of Brussels, which reversed the lower court's decision and granted Elliott's petition for an injunction restraining

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governing the decision on an injunction (the plaintiff's likelihood of success on the merits, the harm to the plaintiff in the absence of the injunction, the harm to the defendant upon grant of the injunction, and public interest) without ever distinguishing among the four parts as to analytical order, priority, or weight. And it has collectively referred to these undifferentiated parts as 'the traditional standard' for injunctions." In the immediate instance, it may be said that to establish likelihood of success on the merits, the plaintiff will need to prove that a valid contract exists between the plaintiff and the defendant, that the defendant has unilaterally declared that it will no longer perform its obligations under the contract, and that this declaration by the defendant constitutes a breach of the contract. The entrance into the contract for debt and the unilateral declaration of non-performance by the defendant are the only conduct that constitute "elements" of the plaintiff's claim, and, if proven, would entitle plaintiff to relief.

[3] The principle of *pari passu* is generally understood to mean "equitably and without preference". See definition: *"Pari passu. [Latin "by equal step"] Proportionally; at an equal pace; without preference <creditors of a bankrupt estate will receive distributions pari passu>. This term is often used in bankruptcy proceedings where creditors are said to be 'pari passu' which means that they are all equal and that distribution of the assets will occur without preference between them."* Source: Black's Law Dictionary (Eighth Edition). Bryan A. Garner, Editor in Chief. West Publishing Company (2004). ISBN 0-314-15199-0.

[4] See Elliott Assocs. v. Banco de la Nacion, 194 F.3d 363 (2d Cir. 1999).

[5] See Elliott Associates, L.P., General Docket No. 2000/QR/92 (Court of Appeals of Brussels, 8th Chamber, Sept. 26, 2000).

payment by Peru's paying agents.[6] The Court was persuaded to accept Elliot's argument largely on the basis of compelling expert witness testimony.[7]

Note in particular that Elliott intentionally waited until just before the payment was due to be made before filing the petition with the Court. When Elliott petitioned the Court of Appeals to reverse the lower Court's decision, Peru was confronted with the immediate choice of whether to pay Elliott and thereby be able to make the payment to its other creditors on time, or to contest Elliott's petition and thereby enter into default on its payment obligation to its other creditors (thereby triggering the entire debt as immediately due and payable by Peru).

Post-*Elliott* Developments

Subsequent to the Belgian court's decision in *Elliott*, Red Mountain Finance, a holder of debt issued by the Democratic Republic of the Congo, sought an order from a California court for specific performance of the *pari passu* clause. The Court enjoined the Congo from making payments to other creditors absent a "proportionate payment" to Red Mountain.[8] In the face of the ruling, the Congolese government settled the debt. Additional actions have been brought in New York and London seeking rulings enjoining non-proportional payments to other creditors.[9]

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[6] See *"Sovereign Debt Restructuring: Should We Be Worried About Elliott?"* (International Finance Seminar Research Paper, Sandoval, Harvard Law School, May 2002). Elliott was awarded a judgment by the U.S. Court of Appeals. The Court of Appeals of Brussels attached Peru's interest payments on the new bonds, which were located in Euroclear accounts in Brussels, and awarded Elliott a restraining order against Peru's paying agents on the basis of an innovative interpretation of the *pari passu* doctrine as contained in the loan agreement. The "ratable payment" interpretation was made by the Court of Appeals of Brussels. Elliott sought to enforce collection of the judgment by preventing or intercepting any payments made by Peru through its paying agents, (i) by attempting to attach funds at the level of the fiscal agent, and then (ii) by capturing funds at the level of the clearing houses. Note that Euroclear is domiciled in Belgium, and Clearstream Banking is domiciled in Luxembourg. See also Republic of Nicaragua v. LNC Investments and Euroclear Bank SA (General Docket No. 2003/KR1334 Ct. App. Brussels, 9th Chamber, March 19, 2004). Injunction issued against paying agent by Belgian Commercial Court, Sept. 8, 2003. Of interest in matters involving the grant of injunction for prejudgment asset-freeze, the U.S. Supreme Court in Grupo Mexicano de Desarrollo v. Alliance Bond Fund Inc. (527 U.S. 308, 119 S.Ct. 1961, 144 L.Ed.2d 319, 1999) confirmed the power of a federal court to issue a prejudgment asset-freeze injunction where the underlying action asserts a claim to assets in the defendant's possession or seeks equitable relief. Since a fraudulent conveyance action to recover money or personal property was held by the Supreme Court in Granfinanciera v. Nordberg (492 U.S. 33, 109 S.Ct. 2782,106 L.Ed.2d 26, 1989) to be a legal, not equitable, claim, a prejudgment asset-freeze injunction may not be available in that type of case. Nonetheless, for fraudulent conveyance actions, such injunctions would appear to be properly based on 11 U.S.C. § 105(a), which authorizes the court to issue any order that is necessary or appropriate to carry out the provisions of the Code.

[7] See testimony presented by Mr. Andreas Lowenfeld, Herbert and Rose Rubin Professor of International Law, New York University School of Law (copy attached). Mr. Lowenfeld testified as an expert witness on behalf of Elliott Associates regarding the proper interpretation and application of the *pari passu* legal principle.

[8] See Red Mountain Finance, Inc. v. Democratic Republic of Congo and National Bank of Congo, Case No. CV00-0164R (C.D.Cal. May 29, 2001).

[9] See Kensington International, Ltd. v. BNP Paribas S.A., Case No. 03602569 (Sup. Ct. N.Y. Co. 2003), wherein the Court dismissed the complaint on forum non conveniens grounds. See also, Kensington International, Ltd. v. Republic of Congo, 2002 Case No. 1088 (Commercial Ct. April 16, 2003), aff'd 2003

The Belgian Supreme Court is presently considering an appellate court ruling that reversed an injunction entered by the commercial court against payments by Nicaragua.[10]

It appears that the facts comprising the immediate instance are comparable to the facts comprising the *Elliott* instance, (e.g., in both instances, the defaulted creditors are holders of fractional interests [debt contracts or bond certificates] evidencing full faith and credit debt originated by bank(s) to the benefit of a sovereign debtor). The approach successfully employed by Elliott may be effectively employed in the immediate instance to prevent the Chinese government from continuing its opportunistic practice of selective default by engaging in discriminatory payments to holders of its recently-issued sovereign bonds while continuing its attempt to escape the repayment obligation to its defaulted creditors.

The Debt Comprising The Chinese Government Five Per Cent Reorganization Gold Loan Is General Obligation, Internationally-Issued, Foreign-Currency-Denominated, Full Faith And Credit Sovereign Debt Of The Government Of China And Remains An Obligation Of The Present Government Of China Under The Successor Government Doctrine Of Settled International Law Espousing Continuity Of Obligations:

» International and United States Authorities:

See Pieter H. F. Bekker, *"The Legal Status of Foreign Economic Interests in Occupied Iraq",* American Society of International Law (July 2003). International decisions have recognized that it does not matter that the former Government represented a dictatorship. See, e.g., Tinoco Case (Gr. Br. V. Costa Rica), U.N. Reports of International Arbitral Awards, Vol. I, 369, 375 (1923), reprinted in 18 AJIL 147 (1924). The decision held that the new government of Costa Rica was bound by concessions and bank notes given by Tinoco, the former dictator of Costa Rica, to British companies, and dismissed as irrelevant that Tinoco's regime was unconstitutional under Costa Rican law and had not been recognized by several states. The United Nations Security Council has never declared null and void the contracts of a former government of a U.N. member state and its authority to do so would be questionable. Article 46 of the Hague Regulations makes clear that "private property", which can be said to include proprietary rights granted in a state contract, "must be respected". See also, Paragraph 17 of the United Nations Security Council Resolution 687 (1991), whereby the Council decided that Iraqi statements repudiating its foreign debt were null and void. See also, United Nations General Assembly Resolution V (Dec. 2, 1950) acknowledging the status of contractual rights as property ("No one shall be deprived of property, including contractual rights, without due process of law and without payment of just and effective compensation"). See also, Restatement (Third) of the Foreign Relations Law of the United States (1986), Section 712(2). See also, *"Creditors' Claims in International Law",* 34 Int'l Law. 235 (2000). See also, the court's reasoning in Pravin Banker Associates v. Banco Popular Del Peru, 1997 WL 134390 (2nd Cir. NY), as cited in *"Collection of Sovereign Debt",* Robert S. Rendell, International Financial Law Review, June 1997, which noted that courts will not extend comity to foreign proceedings when doing so would be contrary to the policies or prejudicial to the interests of the United States. The court further noted that the United States steadfastly maintains the policy of ensuring the enforceability of valid debts under principles of

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EWCA Civ. 709 (C.A. May 13, 2003). Compare Nacional Financiera S.N.C. v. Chase Manhattan Bank, N.A., 2003 WL 1878415 (S.D.N.Y. April 14, 2003).

[10] See supra note 6. Please note that relevant post-*Elliott* decision(s) issued by the Belgian Commercial Court, the Court of Appeals of Brussels and the Belgian Supreme Court (or at least scholarly monographs referencing such decisions) may be accessed at the following web site: ***http://www.emta.org***

contract law. Accordingly, the Second Circuit affirmed the District Court's ruling that Pravin's claims should be recognized notwithstanding international comity considerations.

» Excerpt of language of Article IV. of the Loan Agreement for the Origination of the Chinese Government Five Per Cent Reorganization Gold Loan:

> *"ARTICLE IV. – The entire loan together with any advances which may be made in connection therewith, is hereby secured in respect to both principal and interest by a charge upon the entire revenues of the Salt Administration of China, subject to previous loans and obligations already charged on the security thereof and not yet redeemed, as detailed in the statement attached to this Agreement,* [* See statement printed on pp. 1030-31, post.] and it shall have priority both as regards principal and interest over all future loans, charges and mortgages charged upon the above-mentioned revenues so long as this loan or any part thereof shall be unredeemed. No loan, charge or mortgage shall be raised or created which shall take precedence of or be on an equality with this loan, or which shall in any manner lessen or impair its security over the said revenues of the Salt Administration of China, so far as required for the annual service of this loan, and any future loan, charge or mortgage charged on the said revenues of the Salt Administration shall be made subject to this loan, and it shall be so expressed in every agreement for any such loan, charge or mortgage. If at a future time the annual collection of the Maritime Customs revenues should exceed the amount necessary to provide for all existing obligations charged thereon or which may have become chargeable thereon under existing agreements by reason of the abolition of likin consequent upon tariff revision, it is understood and agreed that such surplus shall be applied in the first instance to the security and service of this loan, the surplus of the salt revenues being thereby pro tanto increased and made available for the general purposes of the Chinese Government."*

» Excerpt of language appearing on the bond certificates of said loan:

The language appearing on the bond certificates explicitly states, "These obligations are intended to be binding upon the Government of China and any Successor Government".

» Determination by the United States Foreign Claims Settlement Commission:

The U.S. Foreign Claims Settlement Commission (the "FCSC") in the matter of Carl Marks & Co., Inc., (Foreign Claims Settlement Commission, Claim No. CN-0420; Decision No. CN-472, March 11, 1971) determined that said debt represents a general obligation of the government of China.[11]

The 1913 Creditors Of The Government Of China Are Members Of, And Do Comprise The Same Class Of Pre-Existing And Equally-Ranked General Obligation Creditors As Purchasers Of Recently-Issued Chinese Government Sovereign Bonds.

The language of Article IV of the Loan Agreement (e.g., prohibiting any encumbrance or mortgaging of revenues securing the debt, and which security was subsequently acquired by, and into the possession of, and subjected to the dominion of, the present government of China at the time that such government acceded to control over China, and which revenues did at that time become revenues of the general treasury of the present government of China, and which

[11] Note that the Communist Chinese government explicitly repudiated this debt in a 1983 *Aide Memoire*, in which the Chinese government declared "The Chinese government recognizes no debts incurred by the past reactionary governments of China and has no obligation to repay them." The repudiation of this debt by the Communist Chinese government invoked established principles of international law.

government did subsequently encumber and pledge such revenues to the repayment of new sovereign debt of the Chinese government in violation of Article IV) may be persuasively argued (particularly in light of the FCSC's determination that the debt is an general obligation of the government of China) to constitute a *pari passu* clause and thus establish the 1913 creditors of the Chinese government as comprising the same class of foreign general obligation creditors of the government of China as purchasers of sovereign bonds recently issued by the government of China, and which creditors are therefore entitled to equal treatment. On this basis and by invoking *Elliott's pari passu* precedent, an *ex parte* pre-judgment request for a restraining order should be submitted to the Belgian Commercial Court in an attempt to prevent a discriminatory payment by the Chinese government to selected creditors comprising a specific class of creditors while simultaneously excluding other creditors who are members of that same class.

» In order to successfully obtain a grant of injunction restraining such payments, it will be necessary to review the status of the proceedings in *Nicaragua* presently pending before the Belgian Supreme Court along with both parties' memoranda of law, and to thoroughly examine the appellate court's reasoning in the matter (which resulted in the appellate court reinterpreting its own precedent).[12]

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[12] For an excellent discussion of remedies available to defaulted sovereign creditors, and in particular the issues pertaining to enforcement of ratable (i.e., proportional, or pro rata) payments pursuant to the *pari passu* principle, see *"Market Discipline in Sovereign Debt: Reinforcing the Rights of Bondholders and Private Creditors"*, Kathryn Brown (paper submitted in fulfillment of the written work requirement for the International Finance Seminar, Harvard Law School, 2006). The author notes the following: *"In Red Mountain Finance Inc. v. Democratic Republic of Congo & National Bank of Congo, 2000 U.S. Dist. LEXIS 22324, (C.D. Cal. May 29, 2001) (judgment) (No. CV 00-0164 R), Red Mountain Finance successfully invoked the pari passu clause in its 1980 credit agreement with the Republic to enjoin the sovereign from making any payments in respect of its External Indebtedness (as defined in the relevant credit agreement) without making pro rata payments to Red Mountain Finance. The case subsequently settled. It is suggested by the Belgian Courts that a pari passu clause in state creditors is primarily intended to prevent the legislative earmarking of revenues of the government or the legislative allocation of inadequate foreign currency reserves to a single creditor and is generally directed against legal measures which have the effect of preferring one set of creditors over the others or discriminating between creditors at a time when the state is unable to pay its debts as they fall due (Kensington International Ltd v Republic of the Congo, 2002 No. 1088, Commercial Court, 16 April 2003, page 33-34 of the judgment of Tomlinson J, quoting from paragraph 3418 of the current Encyclopedia of Banking Law). In Nacional Financiera, S.N.C. v. Chase Manhattan Bank, N.A. et al, 2003 WL 1878415 (S.D.N.Y.), Judge Martin of the U.S. District Court for the Southern District of New York noted that the pari passu covenant may "have given the Smith Parties the right to obtain an injunction to bar Tribasa from making preferential payments to some of its note holders and that another note holder with notice of that injunction could be liable . . . if it thereafter accepted preferential payments." In Kensington Int'l Ltd. v. BNP Paribas S.A., (N.Y. Sup. Ct. Aug. 13, 2003) (No. 03602569), Kensington alleged that since Congo-Brazzaville was still in default of its 1984 loan agreement with Kensington, BNP's acceptance of payments under a new debt financing agreement with Congo-Brazzaville was in breach of the pari passu clause in the 1984 agreement. In Republic of Nicaragua v. LNC Investments & Euroclear Bank S.A., the Belgian trial court granted an injunction preventing Euroclear from processing payments on certain bonds of Nicaragua on the basis of a pari passu covenant in a 1980 loan agreement between LNC Investments and Nicaragua. However, in mid-March 2004 an appellate court vacated the ruling (also without discussing or deciding the pari passu issue on its merits), finding that the lower tribunal's ruling improperly imposed an obligation on Euroclear to help enforce Nicaragua's payment obligation to LNC. See Chamberlin, supra note 147, 3-4. Most recently, in Greylock Global Opportunity Master Fund Limited and Greylock Global Distressed Debt Master Fund Ltd. v. Province of Mendoza, 2004 WL 2290900 (S.D.N.Y.) [hereinafter Greylock v. Mendoza], Greylock sought summary judgment declaring that the exchange offer and consent solicitation of the Province of Mendoza (a province of Argentina) violated the terms of its indenture and bond, including the pari passu clause. See Pls' Br. in Greylock v. Mendoza, supra note 148, available at:*

The foregoing is intended to provide a discussion into diverse considerations as respects the filing of petitions with courts in various jurisdictions for the purpose of seeking injunctions restraining discriminatory and exclusionary payments by the government of China to preferential creditors, thereby terminating the Communist Chinese government's ability to continue to engage in the practice of evasion of proportional payments to defaulted creditors comprising the same class of general obligation foreign creditors of the Chinese government.[13] We now examine specific obligations which may be targeted for injunctions restraining payment absent proportional payments.

Specific Obligations Targeted For Injunction(s) Restraining Payment

The specific payments to be initially targeted pertain to the sovereign obligations (comprising both notes and bonds) issued by the Communist Chinese government in 2003 and 2004.[14] Both offerings were extensively marketed to European investors and the 2003 offering was registered in the United States.[15] The primary distribution by jurisdiction of the 2004 offering is described in the following table ("Exhibit 2"):

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http://www.emta.org/members/Mendoza_Plaintiffs_Memo_of_Law.pdf.
The defendant sovereign argued that the pari passu clause in the bond terms had the effect of preventing the contractual or other legal subordination of the Existing Bonds. Since Greylock had rejected the exchange offer, it retained, unsubordinated, its contractual right to 10% interest of the existing Bonds and to full principal at maturity in 2007, and the right to sue for those amounts. See Def.'s Br. in Opposition to Pls' Motion for Summary Judgment in Greylock v. Mendoza, supra note 148, available at:
http://www.emta.org/members/Greylock.pdf. On 22 December 2004, however, the plaintiff and defendant jointly filed a stipulation that withdrew the Plaintiff's allegation in the Amended Complaint dated 15 October 2004, relating to the pari passu clause. The Court so ordered on 29 December 2004. Opinion and Order of Justice Baer Jr in Greylock v. Mendoza, supra note 148, available at:
http://www.emta.org/members/Mendoza%20Images.pdf."

[13] See the recent statement by the Emerging Markets Creditors Association (the "EMCA") in an apparent and implied endorsement of the interpretation of the principle of *pari passu* as interpreted in by the Court in *Elliott*. While supporting the view that the question of interpretation was not a currently justiciable controversy, the EMCA stated that the interpretation recently advanced by Argentina highlighted the *"apparent willingness of some sovereign debtors to discriminate unfairly among creditors of equal ranking to the detriment of the fairness and trust necessary to ensure that debt reschedulings can be successfully completed and eventually return the debtor to the voluntary markets"*. Id., at 38. Justice Griesa of the United States District Court for the Southern District of New York recently noted the industry interest in the issue of the interpretation of the *pari passu* clause, but held that there was no current dispute which rendered the issue justiciable at this time. See Tr. Allan Applestein, Trustee FBO D.C.A. Grantor Trust v. The Republic of Argentina and Province of Buenos Aires, No. 02 Civ. 1773 (TPG) 6-10 (S.D.N.Y. Jan. 15, 2004).

[14] In particular, we identify and recommend that priority be accorded to the following payments: the October 28th payment to European holders of the Chinese government's 3.75% Notes due 2009 (ISIN XS0203592422 - the designated paying agent responsible for processing this payment is JPMorgan Chase Bank Luxembourg S.A.); the October 29th payment to European holders of the Chinese government's sovereign obligations due 2013 (ISIN XS0178312913); the October 29th payment to European holders of the Chinese government's 4.75% Notes due 2013 (ISIN US712219AJ30 - the designated paying agent responsible for processing this payment is JPMorgan Chase Bank Luxembourg S.A.); the October 28th payment to European holders of the Chinese government's 4.25% Bonds due 2014 (ISIN XS0203685788 - the designated paying agent responsible for processing this payment is JPMorgan Chase Bank Luxembourg S.A.); and the October 28th payment to European holders of the Chinese government's sovereign obligations due 2027 (ISIN US712219AG90).

Exhibit 2

Chinese Government 2004 Sovereign Debt Sale

Primary Distribution by Geographic Region and Investor Category [16]

§2.01 Euro Tranche: €1 Billion 4.25% Bonds Due 2014 / ISIN XS0203685788 [17]

(%) Distribution by Region / Country	(%) Distribution by Investor Category
Europe (83%)	Pension Funds, Insurers and Central Banks (31%)
Asia (16%)	Fund Managers (36%)
Other (1%)	Banks (27%)
Germany (27%)	Retail [33 Accounts] (5%)
Singapore (10%)	Other (1%)
Italy (8%)	[Note: euro tranche subscribed by 220 total accounts]
France (8%)	--
U.K. (6%)	--
Ireland (5%)	--
Greater China (4%)	--

§2.02 Dollar Tranche: $500,000,000 3.75% Notes Due 2009 / ISIN XS0203592422 [18]

(%) Distribution by Region / Country	(%) Distribution by Investor Category
Onshore China (50%)	Banks (70%)
Asia [Other Than China] (30%)	Fund Managers (14%)
Europe and Offshore U.S. (20%)	Private Banks (8%)
--	Other (8%)
--	[Note: dollar tranche attracted an order book of $1.5 billion and 95 accounts / approximately $600 million of the total was subscribed by anchor investors, the majority of which are in China]

Choice Of Venue: Injunction By U.S. Court Restraining Discriminatory Payments May Be Restricted To U.S. Payors

A pre-judgment injunction restraining discriminatory payments to selected creditors absent a non-proportional payment to defaulted creditors comprising the same class of senior foreign holders of the Chinese government's full faith and credit sovereign obligations may be sought from a U.S. Court and, as respects the enjoinment of payments to European creditors, through the Belgian Commercial Courts. Based upon a review of Elliott's experience in New York, it appears uncertain whether a U.S. court granting an injunction restraining discriminatory payments may be assumed to order the enforcement of the injunction against the foreign and overseas branches of U.S. fiscal, paying, transfer or clearing agents.[19]

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[15] See U.S. Registration Statement (Registration no. 333-108727): *http://www.sec.gov/Archives/edgar/data/909321/000114554903001347/u98681p1e424b5.htm*

[16] Source: *"China Wows Europe",* Jackie Horne (FinanceAsia.com, October 22, 2004).

[17] The euro tranche was managed by BNP Paribas, Deutsche Bank, and UBS.

[18] The dollar tranche was managed by Goldman Sachs, JPMorgan, Merrill Lynch and Morgan Stanley.

[19] In Elliott's instance, note that the District Court granting the injunction in the United States declined to extend enforcement of the order against the foreign operations of the New York paying agent. Elliott

In light of Elliott's experience, it would appear to be advisable to petition a United States District Court for a grant of injunction restraining discriminatory payments to U.S. creditors holding the Chinese government's sovereign obligations registered in the United States and offered and sold in 2003. Recall that the restraining order issued by the District Court in *Red Mountain Finance* enjoining exclusionary payments to selected creditors, absent a proportional payment to petitioner, mirrored the Belgian appellate court's interpretation of the *pari passu* principle in the decision sought and successfully obtained by Elliott.

At such time as a petition is presented to a U.S. court requesting a grant of injunction restraining discriminatory payments, it should prove advantageous that an instrumentality of the United States government (i.e., the Foreign Claims Settlement Commission, an agency of the United States Department of Justice) has published a determination that the debt obligations at issue constitute a general obligation of the government of China, establishing such creditors in the same creditor class as holders of the sovereign obligations of the Chinese government which were publicly offered and sold to investors in 2003 and again in 2004.

Presence In The U.S. Of Bonds Registered In The U.S. And Sold In 2003

Please note that the ISIN number referencing the bonds registered in the United States and sold in 2003 does not appear on the TRACE system operated by NASDAQ. As a practical matter, we would expect that some quantity of the bonds sold in 2003 are presently resident within the United States, since we do not imagine that the filing of a U.S. registration statement was undertaken as a frivolous exercise. Even assuming a fractional quantity of bonds registered and sold in 2003 are present in the United States, such bonds would be subject to an injunction issued by a U.S. Court restraining exclusionary and discriminatory payments within the class of senior general obligation foreign creditors of the Chinese government. The inability of the Communist Chinese government to preferentially and selectively honor its sovereign obligations held by the U.S. creditors would then constitute an act of default under the terms of the debt contract as respects the obligations issued and sold by the Chinese government in 2003, and thereby call the debt sold in 2003 as immediately due and payable. An order by a U.S. court restraining exclusionary payments would also act to prevent post-issuance entry of Chinese government debt securities into the United States via the 144(A) exemption, effectively barring U.S. entry of the obligations issued and sold by the Communist Chinese government in 2004.

Effect Of Restraining Discriminatory Payments To Selected Creditors

The event of default, and the likelihood of additional judicial actions brought by induced purchasers of the obligations publicly offered and sold by the Chinese government and its authorized agents in 2003 and 2004, would create an interesting dilemma for the international credit rating agencies. If the agencies continue to ignore the defaulted sovereign obligations of the Chinese government, such actions will be revealed as unequivocally fraudulent. Conversely, if the rating agencies reclassify the Chinese government into the proper and truthful classification, as defined by Standard and Poor's "Selective Default" classification and the equivalent Moody's and Fitch' classifications, the agencies (along with the underwriters and other culpable participants in the artifice) may face legal actions initiated and prosecuted by various members of the entire class of induced purchasers of the obligations publicly offered and sold in 2003 and in 2004.

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subsequently filed multiple separate requests for restraining orders in the various foreign jurisdictions where payment could be made to selected creditors.

Supplemental Information: Prosecution of Civil Tort Claims

Wrongful Actions of the International Credit Rating Agencies

We have proposed to counsel the development and prosecution of a civil action in United States Federal Court to terminate the continuation of the tort injury sustained by defaulted creditors, and to recover repayment of the Chinese government's defaulted sovereign obligations and to further recover damages from the wrongful actions of the defendants, including the intentional actions involving publication and distribution of knowingly false and injurious content. This action has been in development for several months, and a civil complaint is expected to be filed in the very near future. Certain of the claims which we have specifically requested counsel to research and incorporate into the complaint are discussed below, beginning with a discussion of the relevant standard of care for publishing a rating and the proximity to injury of the prevailing "investment-grade" international sovereign credit rating classifications assigned to the government of China by the three primary rating agencies, and which agencies collectively control nearly 95% of the total global market, as illustrated in Exhibit 3, below:

Exhibit 3

Global Credit Rating Market
Percentage Market Share (2005) [20]

Credit Rating Agency	(%) Share of Total Market
Standard and Poor's	40%
Moody's Investors Service	39%
Fitch Ratings	15%

As regards the development, assignment, publication and distribution of a debt rating classification, we observe that the "*qualitative* assessment" component of a specific international sovereign credit rating classification is inherently subjective in nature and this metric must not be recklessly applied (e.g., as evidenced by an instance in which the extant facts contradict the stated conclusions of the qualitative assessment, as respects, for example, the *willingness* of a sovereign to repay its debts in the face of a demonstrated and unequivocal unwillingness to pay).

We further observe that the "*quantitative* assessment" component of a specific international sovereign credit rating classification is, by contrast, objective in nature and must not be recklessly applied (e.g., as would be revealed in an instance in which the rating classification is factually incorrect or knowingly inaccurate as in the immediate instance, e.g., the omission of pertinent facts and the contradictory and inconsistent application of published criteria and definitions to existing facts, and which may have the action of causing injury as evidenced, for example, by the inducement of offerees through the misstatement of risk and the taking of rights in contract of defaulted creditors).

[20] Source: *"Senate Panel Backs Expansion of Credit-Rating Competition",* industry news article by James Tyson, Bloomberg News (August 3, 2006). The article cites reference to calculations derived from company filings. The article states that according to Senate Banking Committee Chairman Richard C. Shelby, *"By increasing competition, the bill will protect investors by improving ratings quality and providing greater transparency and accountability."* According to the article, Committee Chairman Shelby further explained, *"The thrust behind all this is competition, which is desperately needed."*

An examination of the facts comprising the immediate instance (i.e., the existence of defaulted sovereign debt of the government of China) reveals that the prevailing rating classifications assigned by the three largest international credit rating agencies, which collectively control nearly 95% of the market, and which ratings track closely together with little variance, fail to conform to their respective published definitions when confronted with the factual evidence, as illustrated in Exhibit 4 and Exhibit 5, and so act to conceal the existence of the defaulted sovereign debt of the Chinese government, upon which that government refuses to honor repayment in violation of the successor government principle of settled international law.[21] The prevailing rating classifications assigned to the government of China are thus provably false by the application of the agencies own criteria and the published definitions of their respective rating classifications.[22] The following exhibit describes the prevailing international sovereign credit rating classifications assigned by the three primary rating agencies to the long-term foreign currency debt of the Chinese government.

Exhibit 4

Prevailing Sovereign Credit Rating Classifications

Long-Term Foreign Currency Debt of the Chinese Government [23]

Agency	Rating	Definition
Standard & Poor's	A	An obligor rated 'A' has STRONG capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories.
Moody's	A2	Bonds which are rated "A" possess many favorable investment attributes and are to be considered as upper medium-grade obligations. Factors giving security to principal and interest are considered adequate, but elements may be present which suggest a susceptibility to impairment some time in the future. The addition of a "2" denotes mid-range ranking within the assigned rating classification.
Fitch	A	High credit quality. 'A' ratings denote expectations of low credit risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.

Compare the above rating classifications with the published definitions maintained by the same agencies as illustrated in Exhibit 5, which definitions truthfully describe the genuine rating classifications in light of the factual evidence (i.e., the actions of the Communist Chinese government with respect to evasion of repayment of its defaulted sovereign debt, including the actions of repudiation; selective default; rejection of the successor government doctrine of settled international law; discriminatory settlement with Great Britain; and the practice of preferential, exclusionary and discriminatory payments to selected general obligation creditors of the government of China).

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[21] Standard and Poor's and Moody's Investors Service collectively control 79% of the market. We note that both the existence as well as the effect of the duopoly enjoyed by the two primary international credit rating agencies was explicitly acknowledged by the U.S. Congress by reference to the title of recently proposed legislation (H.R. 2990 and S.B. 3850) subsequently enacted as Public Law No. 109-291 on September 29, 2006, i.e., the "Credit Rating Agency Duopoly Relief Act of 2006".

[22] Please see, e.g., Exhibit 4, which presents a depiction of the prevailing sovereign credit rating classifications assigned to the long-term foreign currency debt of the government of China by the primary international credit rating agencies, in comparison with the published definitions of the rating classifications as illustrated in Exhibit 5.

[23] Prevailing long-term foreign currency sovereign credit rating classifications assigned to the Chinese government as of August 1, 2006 by the three largest nationally recognized statistical rating organizations.

Exhibit 5

Truthful and Proper (i.e., Non-Injurious) Rating Classifications
Long-Term Foreign Currency Debt of the Chinese Government
As Determined by Conformance of Agencies' Published Criteria and Definitions to
Facts Comprising the Actions of the Communist Chinese Government, Including:
[1] **Repudiation**; [2] **Selective Default**; [3] **Rejection of Successor Government Doctrine of International Law**; [4] **Discriminatory Settlement with Great Britain**; [5] **Preferential and Discriminatory Payments to Selected General Obligation Creditors** [24]

Agency	Rating	Definition
Standard & Poor's	SD (Selective Default)[25]	An obligor rated "SD" (Selective Default) has failed to pay one or more of its financial obligations (rated or unrated) when it came due. An "SD" rating is assigned when Standard & Poor's believes that the obligor has selectively defaulted on a specific issue or class of obligations but it will continue to meet its payment obligations on other issues or classes of obligations in a timely manner.[26]
Moody's	Ba (high range) Caa (low range)	Bonds which are rated "Ba" are judged to have speculative elements; their future cannot be considered as well-assured. Often the protection of interest and principal payments may be very moderate, and thereby not well safeguarded during both good and bad times over the future. Uncertainty of position characterizes bonds in this class. Bonds which are rated "Caa" are of poor standing. Such issues may be in default or there may be present elements of danger with respect to principal or interest.[27]
Fitch	DDD RD (Proposed)	Default. Entities rated in this category have defaulted on some or all of their obligations. Entities rated "DDD" have the highest prospect for resumption of performance or continued operation with or without a formal reorganization process. Proposed new rating classification: a newly introduced rating of "RD" (Restrictive Default) is proposed for assignment to an issuer (including sovereigns) in cases in which the issuer has defaulted on one or more of its financial commitments, although it continues to meet other obligations.

[24] According to the United States Foreign Bondholders Protective Council, established by the U.S. Department of State, Department of the Treasury, and the Federal Trade Commission for the purpose of assisting U.S. citizens in recovery of repayment of defaulted obligations of foreign governments, the Communist Chinese government represents the only instance, in over 40 successful settlements of defaulted sovereign debt, of a government refusing to negotiate the settlement of its defaulted sovereign debt.

[25] Recent instances in which Standard and Poor's has assigned an "SD" rating classification to the long-term foreign currency debt of a sovereign issuer include Russia in 1998 (which defaulted on its domestic obligations while continuing to service its eurobonds); Argentina, following its sovereign debt default in December 2001 and subsequent restructuring, including an exchange offer to existing bondholders; and the Dominican Republic in 2005 (which became delinquent on payments owed to commercial bank creditors while continuing to service its bonded debt). The "SD" rating remained in full force and effect until all outstanding defaulted obligations were resolved.

[26] A prime example of "Selective Default" is the series of full faith and credit sovereign obligations issued as the "Chinese Government Five Per Cent Reorganization Gold Loan", scheduled to mature in 1960 and which debt remains in default as an external payment obligation of the successor government of China (i.e., the Communist Chinese government, which was established on October 1, 1949). The Communist Chinese government replaced the Republic of China in the United Nations as the recognized government of China on November 23, 1971 and was subsequently recognized as the government of all China. Taiwan publicly renounced any claim to the government of all China in 1991.

[27] This rating classification is appropriate with respect to acknowledging the judicial risk inherent to investment in such obligations arising from the discriminatory and preferential treatment of selected general obligation creditors.

As illustrated in Exhibit 5, the Communist Chinese government continues to engage in a pattern of discriminatory, exclusionary and preferential practices while refusing repayment of its sovereign obligations for which it is legally responsible as the successor government of all China, and which actions are concealed by the assignment, publication and distribution of false international sovereign credit rating classifications by the three primary rating agencies, the published definitions of which do not conform to the fact pattern comprising the immediate instance.[28] It is the ability of the Communist Chinese government to engage in international debt financing in reliance upon its prevailing rating classifications, and so establish and maintain a sovereign benchmark for the benefit of Chinese corporate issuers, which constitutes the proximate mechanism by which the Chinese government is able to escape its repayment obligation to defaulted creditors. It thus becomes evident that the practices engaged in by the primary international credit rating agencies evidence selective adherence to their respective published definitions, methodologies and criteria in order to attain a predefined result and so avoid an inconvenient truth, to the calculated effect of maximizing their profits.[29]

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[28] See in particular the Communist Chinese government's unwillingness to respect repayment of the defaulted full faith and credit sovereign obligations held by United States citizens, for which the government of China is liable under the successor government convention of settled international law and which convention was invoked by the 1983 *Aide Memoire* in which the Communist Chinese government explicitly attempted to repudiate its obligation to repay the debt. We further note the determination by the United States Foreign Claims Settlement Commission in *Carl Marks & Co.* wherein the Commission found that the unpaid debt represents a general obligation of the government of China. By their published definitions, the prevailing sovereign credit rating classifications assigned to the Communist Chinese government exclude and thereby conceal the fact of selective default, as shown in Exhibit 4 and Exhibit 5.

[29] In this regard, we note the following statement, *"NRSROs should be legally accountable for their ratings."* Source: Investment Company Institute, Statement Before the SEC Hearings on Issues Relating to Credit Rating Agencies (November 21, 2002). See also the statement, *"Reliance by credit rating agencies on issuer fees could lead to a conflict of interest and the potential for rating inflation."* United States Securities and Exchange Commission, Rating Agencies and the Use of Credit Ratings Under the Federal Securities Laws (2003). See also the statement, *"Given the steps the SEC has taken to improve levels of independence for accounting firms and equity analysts, similar action should be required to restore the credibility of and confidence in the rating system."* Source: *"Is the SEC Going Soft on Credit Rating Agencies?"* Danvers, Kreag and Billings, B. Anthony, The CPA Journal (May 2004). For further revealing information concerning the unregulated business practices of the three primary international credit rating agencies, see our letter dated June 21, 2005, addressed to Mr. David Walker, Comptroller General of the United States of America, and in particular, footnotes #14 (at 6), #15(at 6,7), #16 (at 7), #19 (at 8,9), and #20 (at 10). The letter is accessible on the world wide web and may be viewed at the following URL:
http://www.globalsecuritieswatch.org/GAO_LETTER.pdf
Christopher Mahoney, Executive Vice President at Moody's was quoted in a recent article entitled, *"China's Pre-War Bond Default Stirs U.S. Anger"* (Gillian Tett in London, Richard Beales and Andrew Parker in New York, and Andrew Yeh in Beijing) published by the Financial Times (June 7, 2005) as stating, *"The fact that a country has defaulted in the past is a credit negative, but it does not preclude … a high rating today."* This article may be viewed on the world wide web at the following URL:
http://www.globalsecuritieswatch.org/Financial_Times_June_7,2005_.pdf
Mr. Mahoney is silent as regards the critical aspect of the same country continuing to evade repayment of its defaulted debt. Interestingly, in this same article an unidentified international banker is quoted as stating that this matter represents, *"…a sensitive issue"*. In an article entitled, *"US Holders Claim on China for Pre-War Bonds"*, EuroWeek (April 8, 2005), an unidentified Asian ratings analyst is quoted as stating that this same matter represents, *"…a hot potato"*. According to a recent article entitled *"The Ratings Game"* by Martin Mayer (July 1999) published by The International Economy, *"All ratings agencies agree that a debtor is in default when it either misses a payment beyond a grace period or seeks to renegotiate the loan – 'anything', says S&P's Marie Cavanaugh, 'that is not 'timely service of debt according to the terms of*

Development of Antitrust Claim Against the International Credit Rating Agencies

Even the most casual observer will note the prevalence of legal and prudential codification of the rating classifications assigned by Standard and Poor's and Moody's Investors Service into investment policies and financial regulations. The extensive and pervasive nature of this practice has acted to empower such ratings with the force of law, and has done so in the absence of regulatory supervision.[30]

The international credit rating industry is described to us by one independent expert as "an absolutely closed shop industry". We also note the statement of the Court in County of Orange v. The McGraw-Hill Companies: *"S&P's position in the securities field may have caused it to assume an independent professional duty enforceable in a tort action"*.[31] The Court further noted that the ratings could be the basis of liability if the plaintiff proved by clear and convincing evidence that Standard and Poor's acted with knowledge that the ratings were false or with reckless disregard of their truth or falsity.[32] The First Amendment does not protect actions which are intentional, knowingly misleading and which cause injury to others. We observe in Jefferson County School District v. Moody's Investors Service that the court reasoned that Moody's

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issue'." In fact, Standard and Poor's own "Selective Default" classification states *"An obligor rated 'SD' (Selective Default) has failed to pay one or more of its financial obligations (rated or unrated) when it came due. An "SD" rating is assigned when Standard & Poor's believes that the obligor has selectively defaulted on a specific issue or class of obligations but it will continue to meet its payment obligations on other issues or classes of obligations in a timely manner."* See supra Exhibit 5. We observe that the Chinese government's defaulted sovereign debt, existing unpaid and in a state of default, has come to rest principally in the hands of individual investors as opposed to institutions, and that the agencies and the advisers to the Communist Chinese government therefore anticipated a very minimal risk of objection via a unified voice as respects the assignment of a long-term foreign currency sovereign credit rating to the Chinese Government which has the action of concealing the existence of the Chinese Government's defaulted sovereign debt. When Standard & Poor's first assigned the rating in 1992, it did not reflect the existence of the Chinese Government's defaulted sovereign debt and established a new, and artificial, foundation upon which the Chinese Government could resume international financing without repaying its defaulted sovereign debt, and also constitute the basis upon which to build the rating over the future term.

[30] See copies of municipal investment policies, financial industry regulations, and retirement system portfolio allocation policies (attached). See also the Memorandum dated July 29, 2005 prepared by the Division of Market Regulation, United States Securities and Exchange Commission, as a response to diverse inquiries from Members of the United States Congress in regard to the Complaint filed with the Commission on behalf of defaulted creditors of the Chinese government dated March 31, 2005, wherein the SEC explicitly disclaimed regulatory jurisdiction over the activities of the nationally recognized statistical rating organizations (i.e., the international credit rating agencies), thereby depriving the agencies of an implied immunity defense as respects civil claims for injuries sustained by actions prohibited under the federal antitrust laws. The Memorandum is addressed to Cynthia A. Glassman, Acting Chairman and is endorsed by Annette Nazareth, Director of the Division of Market Regulation. Ms. Nazareth is presently an appointed Commissioner of the United States Securities and Exchange Commission. A copy of the Memorandum is attached hereto as Exhibit A.

[31] County of Orange v. The McGraw-Hill Companies (no. SA CV 96-0765-GLT, 1997 U.S. Dist., LEXIS 22459, C.D. Cal. June 2, 1997).

[32] Id.

publication was protected by the First Amendment because it neither stated nor implied an assertion that was provably false.[33]

We further note that the privileged, exclusive, influential and select position of the three primary international credit rating agencies within the industry, together with the influence of the industry, constitutes such firms in a "gatekeeper" role, comprising the unique ability and responsibility to select which issuers will be admitted into the international financial markets and on what terms. Note that Standard and Poor's, Moody's Investors Service, and Fitch Ratings are each registered with the SEC as Registered Investment Advisers and as such, they are regulated under the Investment Advisers Act of 1940.[34] The fact of registration in conjunction with the position in the industry of (i) Standard and Poor's, (ii) Standard and Poor's and Moody's Investors Service, and (iii) the three major rating agencies collectively, may act to increase the applicable standard of care required of each of the agencies.

The exclusivity of the franchise, constituted as a duopoly, is the mechanism which empowers the rating, and it is the rating which operates to the effect of stimulating, moving and guiding large capital flows in the international financial markets and in the immediate instance, to a debtor government in default under established principles of international law. In this regard, we take particular note of the following statements:

» Statement by Dr. Adam Lerrick, professor of economics at Carnegie Mellon University evidencing the proximity between the effect of misleading ratings and the "taking" of defaulted creditors' enforcement ability:

> *"If large-scale financing was supplied to governments in default, the incentive for the debtor to conclude a deal was destroyed."* [35]

Note that the wrongful assignment of investment grade sovereign credit rating classifications operate to precisely this effect.[36]

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[33] Jefferson County School District No. R-1 v. Moody's Investors Services, Inc. (175 F.3d 848, Tenth Circuit, 1999). An important distinction in the immediate instance is the ability to allege foreknowledge as opposed to asserting knowledge after the fact, as in the event of default. The prevailing sovereign credit rating classifications assigned to the government of China by the three primary rating agencies are provably false by the application of the agencies' own criteria and published definitions. For an instructive discussion of related circumstances in which debt rating agencies may be held liable for erroneous statements, see, e.g., St. Amant v. Thompson, 390 U.S. 727, 731 (1968). Agencies may be held liable in situations where the agency entertained serious doubts about the truth of its publication. See also, e.g., Garrison v. Louisiana, 379 U.S. 64, 74 (1968). Agencies may be held liable in situations where the agency knew that there was a *"high degree of the awareness of the probable falsity"* of its publication. Such is the case in the immediate instance, where extensive publication and constructive notice can both be demonstrated.

[34] Investment Advisers Act of 1940, as amended, 54 Stat. 847, 15 U.S.C. § 80b-1 - 80b-21.

[35] *"A Leap of Faith for Sovereign Default: From IMF Judgment Calls to Automatic Incentives"*. Lerrick, Adam. Cato Journal. Volume 25, No. 1 (Winter 2005). As a further testament, albeit of an admittedly colloquial nature, to the critical role of rating agencies in establishing marketability of debt instruments, note the widely recognized industry maxim, *"brokers are selling machines when backed by agency ratings"*.

[36] See, e.g., the revealing comment, *"If you have any credibility, you would probably be rating everything junk in China"*. Source: Dr. Scott Kennedy, who specializes in China's political economy at Indiana

» Statements appearing in a scholarly research monograph recently published by Cambridge University Press: [37]

> *"Recent decades have witnessed the remarkable rise of a kind of market authority almost as centralized as the state itself – two credit rating agencies, Moody's and Standard & Poor's. These agencies derive their influence from two sources. The first is the information content of their ratings. The second source is both more profound and vastly more problematic: Ratings are incorporated into financial regulations in the United States and around the world…their ratings are given the force of law. Moody's and Standard & Poor's are based in New York but have an increasingly global reach. Ratings agencies exercise significant and increasing influence over private capital movements (see Sinclair 2005).* ***No sovereign government would dare to issue debt without being rated by one or both of the agencies."*** (Emphasis added; note that this statement would appear to memorialize the precept that assignment of an international credit rating is proximate to a sovereign government's ability to resume international financing). *"A small number of rating agencies are literally, and legally, the 'gatekeepers' to the vast U.S. investing public. The U.S. government thus has put these unregulated firms in the position to express their interpretation of good economic policy to sovereign governments through the process of rating them. Issuers came to see the agencies as points of access to international capital flows. In this paper, we seek…to describe the host of problems that arise when their ratings are given the force of law through incorporation into financial and prudential regulation. Given the degree of reliance the markets and regulators place on credit ratings…the major credit rating agencies' fortunes have risen, fallen, and risen again in tandem with private capital flows. From their origin in 1909, the agencies grew as the bond market expanded from railroad bonds to include issues by utilities, manufacturers, and sovereign governments. The agencies' spectacular expansion since the 1970s has, again, effectively mirrored the growth in private capital flows over recent decades. Among the issuers that have taken part in the rapid expansion of the global bond market are a growing number of sovereign governments. The increasingly central role that a small number of prominent rating agencies have come to play in capital markets as they step into the information –gathering role previously played by banks."* [38]

The foregoing statements by recognized experts in the industry serve to cast additional light upon the power, influence and operation of the rating classifications assigned to issuers by the three primary international credit rating agencies and further corroborate the proximity and causality of injury resulting from wrongful publication. The operation of such effect is further described in Exhibit 6 on the following page.

The ability of the Communist Chinese government to purchase an international sovereign credit rating, including the influence and effect of such rating, which deviates from its published definition and for which China paid and then denied seeking, constitutes the proximate

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University. Wall Street Journal (January 5, 2004). See also the statement: *"China doesn't adhere to international accounting standards. To make matters worse, the government issues misleading statistics."* According to Mr. Brian Colton, an analyst who rates China's sovereign bonds for Fitch Ratings (Hong Kong), *"Sometimes you have a column of figures that don't add up to the total at the bottom. It's that bad."* Wall Street Journal, January 5, 2004. See also the statement by Mr. Gordon Chang, former partner at Paul, Weiss, Rifkind, Wharton & Garrison in Beijing: *"China has less borrowing capacity than many people think; it is not as creditworthy as many people think."* William J. Casey Institute of the Center for Security Policy, May 22, 2001.

[37] *"To Judge Leviathan: Sovereign Credit Ratings, National Law, and the World Economy".* Bruner, Christopher M., and Abdelal, Rawi, Harvard Business School. Cambridge University Press (2005).

[38] Id.

mechanism by which the Communist Chinese government is able to escape its repayment obligation for the Chinese government's defaulted full faith and credit sovereign debt and to engage in a pattern of discriminatory, exclusionary and preferential payments to a select group of its foreign sovereign creditors. This action has the effect of depriving defaulted creditors of their contractual rights in the nature of a "taking" (i.e., an economic tort injury).

We also note that the position of the United States Securities and Exchange Commission as articulated in the Memorandum prepared by the Division of Market Regulation (see supra note 30 and Exhibit A, attached hereto), wherein the Commission disclaimed regulatory jurisdiction over the activities of the international credit rating agencies, has effectively deprived the agencies of an "implied immunity" defense as a response to the prosecution of a claim alleging injury arising from antitrust violation(s). We are of the further opinion that the exemption of the international credit rating agencies from regulation under the Exchange Act, and which exemption thereby places such activities outside the purview of the federal securities laws, serves to strengthen the civil RICO component of the defaulted creditors' claims.

For the foregoing reasons, and based upon additional factual discovery, we have requested counsel to incorporate the specification of antitrust violations to the civil actions presently under development in order to compensate the defaulted creditors for injuries sustained as a direct result of the wrongful actions of the three primary international credit rating agencies in violation of the federal antitrust laws. We are also preparing to file a complaint with the United States Department of Justice alleging violations of the federal antitrust laws by the three named parties. Please note that injuries sustained as a result of wrongful actions under the federal antitrust laws entitle claimants to treble damages.

Exhibit 6

Washington Post Special Feature

Serial Installment Series on the Business Practices of the International Credit Rating Agencies [39]

Date	Feature
Monday November 22 2004	**Unchecked Power**: The world's three big credit-rating companies have come to dominate an important sector of global finance without formal oversight. The rating system has proved vulnerable to subjective judgment, manipulation and conflicts of interest, people inside and outside the industry say. • **Moody's Close Connections** • **When Interests Collide** • **Graphic: The Rating Game**
Tuesday November 23 2004	**Shaping the Wealth of Nations**: As more countries rely on the bond markets to raise capital, they have been forced to accommodate the three top rating firms. The credit raters often have more sway over foreign fiscal policy than the U.S. government. • **Transcript: Post Writer Alec Klein** • **Smoothing Way for Debt Markets** • **Graphic: Moody's Expansion**
Wednesday November 24 2004	**Flexing Business Muscle**: Lack of oversight has left the rating companies free to set their own rules and practices, which some corporations say has led to abuses. The credit raters have rated companies against their wishes and ratcheted up their fees without negotiation. • **Graphic: Raters' Big Misses**

[39] See supra note 29, specifically our letter dated June 21, 2005, addressed to Mr. David Walker, Comptroller General of the United States of America, and in particular, footnotes #14 (at 6), #15(at 6,7), #16 (at 7), #19 (at 8,9), and #20 (at 10). The letter is accessible on the world wide web and may be viewed at the following URL:
http://www.globalsecuritieswatch.org/GAO_LETTER.pdf

Each of the three primary international credit rating agencies have wrongfully maintained and continue to maintain, periodically upgrade, publish, and distribute the prevailing sovereign credit rating classifications assigned to the government of China and have done so and continue to do so in the face of constructive notice.

When considering the significance of an international credit rating to an issuer's ability to issue debt internationally, and an issuer's inability to engage in international financing in the absence of such rating, and the commanding position in the industry occupied by the three main rating agencies, and the compensation practices endemic to the agencies' conduct of their business (as described in graphic detail in a three-part front page series published by the Washington Post, reference to which is presented herein as Exhibit 6), and the role of Morgan Stanley as the credit rating adviser to the Communist Chinese government in 1988, it is revealed that China intended to acquire an international credit rating in order to resume international debt financing, and did then engage an adviser for such purpose, and did then commission and solicit the assignment of an international credit rating on a compensated basis from the primary provider of such ratings, Standard & Poor's. Standard and Poor's was therefore paid by the Communist Chinese government for the assignment of the initial rating classification which did not reflect the existence of China's defaulted sovereign debt.[40] We may then conclude that the Communist Chinese government, after an absence of approximately fifty years from the international financial markets, and in order to establish a sovereign benchmark to facilitate the emergence of international debt financing by Chinese corporate issuers, purchased an international sovereign credit rating, which rating concealed the fact of the Chinese government's defaulted sovereign debt, and owing to the power and influence of the provider of such rating, operated to effectively extinguish any repayment obligation thereof, including the ability of the defaulted creditors to enforce such repayment obligation.

We have requested counsel to petition the court for a grant of injunction restraining and enjoining publication of the prevailing sovereign rating classifications "until paid", to the effect that the prevailing rating classifications are withdrawn and publication is suspended until the plaintiffs' claims are fully paid by the debtor (i.e., the government of China).

Expanded Scope of Action

We are presently examining the role of each of the participants in recent offerings and sales of internationally issued general obligation debt obligations of the government of China in light of evidence pertaining to allegations involving the possible construct and operation of a racketeering scheme or artifice involving active complicity by numerous actors. Accordingly, we are closely examining the roles of each of the Lead Managers and Bookrunners, among other actors, which participated in the underwriting, marketing and paying activities involving the recent offers and sale of sovereign debt obligations of the Chinese government.

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[40] As previously noted and more thoroughly described in the previous section of this Memorandum, captioned "Wrongful Actions of the International Credit Rating Agencies", and as pertains to injury arising from antitrust violations, the three primary international credit rating agencies control nearly 95% of the market and, in consideration of the extremely prevalent practice of both prudential and regulatory codification referencing their assigned ratings, and which fact gives such ratings the force of law without any regulatory oversight, constitute the proximate mechanism by which the Communist Chinese government is able to escape the repayment obligation for its defaulted sovereign debt. We note that each of the rating agencies has been served constructive notice as regards the specifications described herein.

Exhibit 7

Participants Engaged in the Offer and Sale of Recently-Issued Chinese Government Bonds [41]

Year of Issue	Clearing Agents	Joint Lead Managers and Joint Bookrunners	Fiscal Agents and Principal Paying Agents	Legal Advisors
2004	Euroclear Bank S.A./N.V. as operator of the Euroclear System ("Euroclear") Clearstream Banking S.A. ("Clearstream")	**The Bonds** Deutsche Bank (Global Coordinator) BNP Paribas UBS Investment Bank **The Notes** Merrill Lynch International (Global Coordinator) Goldman Sachs (Asia) L.L.C. JPMorgan Morgan Stanley	**Fiscal Agent and Principal Paying Agent** JPMorgan Chase Bank, London Branch **Luxembourg Paying and Listing Agent** JPMorgan Chase Bank Luxembourg S.A.	**To the Issuer as to United States Law** Sidley Austin Brown & Wood LLP **To the Underwriters as to United States Law** Davis Polk & Wardell
2003	Euroclear Bank S.A./N.V. as operator of the Euroclear System ("Euroclear") Clearstream Banking S.A. ("Clearstream") **For Book Entry Securities** Depository Trust Company	Goldman Sachs (Asia) L.L.C. JPMorgan Merrill Lynch & Co. **Underwriters** Banc One Capital Markets Citigroup Global Markets Credit Suisse First Boston Daiwa Securities SMBC Europe Hong Kong and Shanghai Banking Corporation ICEA Securities Lehman Brothers International (Europe) Morgan Stanley & Co. International Nomura International	**Registrar and Fiscal, Paying and Transfer Agent** JPMorgan Chase Bank, New York **Luxembourg Paying and Listing Agent** JPMorgan Chase Bank Luxembourg S.A. **Paying Agents For Book Entry Securities** Depository Trust Company	**To the Issuer as to United States Law** Sidley Austin Brown & Wood LLP **To the Underwriters as to United States Law** Sullivan & Cromwell LLP

Conspiracy to Operate a Fraudulent Scheme or Artifice: Inclusion of Civil RICO Claim

Upon an intensive examination of the facts, it appears to us that certain of the actors did conspire and then act to construct and operate a fraudulent scheme or artifice, and that many actors did willingly participate in the scheme, and that such actions may be demonstrated to be in violation of the federal Racketeer Influenced and Corrupt Organizations ("RICO") Act.[42] This would not appear to be the only instance as respects the engineering, construct and operation of a fraudulent scheme on the part of certain of the parties expected to be named as defendants. For a revealing description of the standard of care evidenced in the immediate instance by certain participants, including the Communist Chinese government and certain other actors, whose actions may have been in violation of U.S. law, specifically Rule 10b-5 and Section 10(b) of the Exchange Act, in connection with the 2003 bond sale, and whose actions may have risen to the level of fraud including associated elements of mail and wire fraud, please see our complaint filed with the U.S.

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[41] All 2004 data derived from the Offering Circular dated October 21, 2004. All 2003 data derived from the U.S. Registration Statement no. 333-108727 (October 16, 2003).

[42] Racketeer Influenced and Corrupt Organizations Act, Title 18, United States Code, Sections 1961-1968, as amended. Note that the civil action(s) and related claims as described herein are of the nature of the recovery of repayment pursuant to a commercial debt transaction, as opposed to claims accruing from any securities transaction(s).

Securities and Exchange Commission dated September 1, 2006.[43] We are informed that the Chinese government engaged Morgan Stanley to act as an adviser in 1988 for the purpose of establishing an international credit rating in order to resume international debt financing, and which credit rating the Chinese government denied seeking. We are further informed that Morgan Stanley was the main bond consignee in 2001, and that the 2001 bond sale marked the return of the Chinese government to the international credit markets. We also note that Goldman Sachs, which acted as the 2003 credit rating adviser to the Chinese government, was provided with constructive notice of the Chinese government's defaulted sovereign debt in early 2002 by a letter dated January 2, 2002 (copy attached).

We believe that the scheme or artifice has had and continues to have the operation of profiting from the mitigation of the effect, and the obligation for repayment, of the Chinese government's defaulted sovereign debt, including the processing of exclusionary, non-proportional and discriminatory payments to newly-solicited and potentially induced creditors of the Chinese government, and to profitably assist and enable the government of China to escape its obligation to repay its defaulted sovereign obligations and to then resume and continue international debt financing in order to establish and maintain a sovereign benchmark with which to enable and facilitate the ability of Chinese corporate issuers to engage in international debt financing, all to the immense profitable benefit of the participants. The role of certain actors is, in part, to enable and to process discriminatory payments to preferential creditors of the Chinese government while selectively excluding other creditors who are members of the same class of the Chinese government's foreign general obligation creditors, and in this manner to assist the Communist Chinese government in engaging in its efforts to escape its repayment obligation to its pre-existing defaulted creditors. We are also informed that the United States government is the obligee of valid sovereign debt contracts payable by the Chinese government and which debt contracts presently exist in a state of default. We anticipate the occurrence of certain imminent events which will have the action of invoking the Johnson Debt Default Act (the "Act"), thereby rendering any person subject to the jurisdiction of the United States who engages in the offer, sale, quotation or trading of sovereign debt obligations of the Communist Chinese government, including participants in the artifice described in the complaint, to be constituted as criminals under the Act.[44]

We have requested counsel to expand the scope of the civil action to include specifications describing injuries sustained as a result of actions perpetrated in violation of the federal RICO statute and to add as defendants such persons whose actions may be demonstrated to have constituted injurious acts prohibited thereunder. We also note that the operation of a racketeering scheme entitles injured parties to recovery of treble damages. This aspect is assistive as we seek the administration of justice in this matter, including recovery of repayment as well as compensatory damages for the wrongful actions of persons which have had the effect of depriving the defaulted creditors of their rightful claims.

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[43] See complaint dated September 1, 2006 filed with the United States Securities and Exchange Commission alleging violations of Rule 10b-5 and Section 10(b) of the Exchange Act as regards the sovereign disclosure obligation specified pursuant to Schedule B. The complaint is accessible on the world wide web at the following URL:
http://www.globalsecuritieswatch.org/Sovereign_Disclosure_Obligation.pdf
To view the amendment to the complaint alleging fraud, please visit the following URL:
http://www.globalsecuritieswatch.org/Amended_SEC_Complaint.pdf

[44] Johnson Debt Default Act, 48 Stat. 574, 31 U.S.C.A. §804a (April 13, 1934). A summary of the Johnson Debt Default Act may be viewed on the world wide web at the following URL:
http://www.globalsecuritieswatch.org/US_Johnson_Debt_Default_Act.pdf

Development of Parallel *Qui Tam* Action

We have also requested counsel to undertake the development of a separate and parallel *qui tam* action referencing certain defaulted sovereign obligations of the Chinese government believed to be held in the possession of the United States government. A *qui tam* action, defined literally as *"who as well for the King as for himself sues in this manner"* enables a private party to pursue legal action in the name of the United States government, and to share any recovery and penalty with the U.S. government.[45] A *qui tam* action is enabled pursuant to the False Claims Act:

> *"(a) federal statute establishing civil and criminal penalties against persons who bill the government falsely, deliver less to the government then represented, or use a fake record to decrease an obligation to the government. The act may be enforced either by the attorney general or by a private person in a qui tam action."*[46]

We note that the Communist Chinese government has failed to deliver the repayment of China's defaulted sovereign debt to United States creditors, including the United States government, and that the wrongful actions of certain other defendants have conspired to decrease an obligation of the same nature as obligations which we are informed are presently held in the possession of the U.S. government. The existence of one or more defaulted direct loans to China by the U.S. government may further constitute the basis for such an action.

At such time as the existence of the Chinese government's defaulted sovereign debt presently resident in the possession of the United States government is publicly revealed through the prosecution of a *qui tam* action, the actions of U.S. dealers in debt securities issued by the government of China and instrumentalities thereof may also be subjected to further criminal penalties by virtue of the provisions of the U.S. Johnson Debt Default Act.[47] The language of the Act states, in part:

> *"Hereafter, it shall be unlawful within the United States or any place subject to the jurisdiction of the United States for any person to purchase or sell the bonds, securities, or other obligations of, any foreign government or political subdivision thereof, issued after the passage of this Act, or to make any loan to such foreign government, political subdivision, organization, or association, except a renewal or adjustment of existing indebtedness while such government, political subdivision, organization, or association, is in default in the payment of its obligations, or any part thereof, to the Government of the United States."*

Pursuant to the Act, it is a federal criminal offence for any party subject to the jurisdiction of the United States to sell the securities of, or engage in the provision of loans or extending of credit to, any foreign government, or organization thereof, which is in default on debt owed to the Government of the United States. The language of the Act may reasonably be construed to

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[45] Black's Law Dictionary (Eighth Edition). Bryan A. Garner, Editor in Chief. West Publishing Company (2004). ISBN 0-314-15199-0.

[46] Id. False Claims Act, 31 U.S.C. § 3729 *et seq.*

[47] See supra note 44. A summary of the Johnson Debt Default Act may be viewed on the world wide web at the following URL:
http://www.globalsecuritieswatch.org/US_Johnson_Debt_Default_Act.pdf
See also the following information accessible on the world wide web:
http://www.centerforsecuritypolicy.org/home.aspx?sid=140&categoryid=140&subcategoryid=147

prohibit the underwriting, offer or sale of securities of the Government of the People's Republic of China or its state-owned enterprise

We believe that it is possible to persuasively argue that the actions of the defendants have operated to the effect of perpetrating a fraud upon the United States government, e.g., that the actions of the defendants which have attempted, and continue to attempt to defraud the United States Government and which actions are constituted as criminal acts pursuant to both the False Claims Act and the Johnson Debt Default Act, which criminalize offences thereunder; such offences to include both the use of a fake record to decrease an obligation to the U.S. government as well as the provision of assistance to an issuer in the sale of debt obligations (and not just those obligations offered within the United States) if such issuer is in default on any obligation payable to the United States government. Such defaulted obligation may include direct loans or debt obligations of any other nature (e.g., bearer obligations).[48]

We believe that the development and prosecution of a *qui tam* action will serve a useful purpose in (i) addressing the possible defrauding of U.S. taxpayers and (ii) strengthening the RICO aspect of the civil complaint, since the defendants' actions are constituted as criminal acts under both the Johnson Debt Default Act and the False Claims Act.[49]

For the foregoing reasons, we have proposed to counsel the development and prosecution of a *qui tam* action for collection of the entire obligation due the United States government, for which the defaulted creditors will be entitled to receive a share of the damages, typically calculated on the basis of 20% - 30% of treble damages.[50] We believe that this represents a rather significant sum. Please note that we intend to engage a prominent national taxpayer advocacy organization to assist in the prosecution of a parallel *qui tam* action on behalf of the United States government and U.S. taxpayers.[51]

Development of a Lender Liability Claim: Legal Action Against Purchasers of Newly-Issued Debt Obligations of the Government of China

We have also requested counsel to determine whether a civil action may be prosecuted against purchasers of recently issued and future-issued debt obligations of the Chinese government for involuntary subordination of existing obligations. Our specific concern is whether the purchasers

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[48] See, e.g., the United States Export-Import Bank loan of 1946. In addition, the United States Government lent in excess of $670 million in pre-war, wartime, and post-war loans to the Government of China, including the $500 million "Wilson Loan" in 1942. Sources: *"Kimber's Record of Government Debts"* (Overseas Statistics, Inc., 1934). *"Foreign Loans to China",* Kao Ping-Shu (Sino-International Economic Research Center, 1946). *"China's Foreign Debt",* W. Kuhlmann (no publisher information available, 1984).

[49] See supra note 44 and supra note 46.

[50] Although the U.S. Government is entitled to claim the majority (e.g., typically 70% - 80%) of damages awarded in a *qui tam* action, this aspect is mitigated by the entitlement to treble damages (in a similar manner as to claims which successfully invoke RICO or antitrust injury).

[51] The numerous letters issued by Members of Congress may be expected to weigh favorably as respects a *qui tam* action. Such action may pose a sensitive issue for the law firm of Sidley Austin Brown & Wood LLP in light of their recent settlement of criminal tax fraud allegations brought by the U.S. Department of Justice. Such action may also pose a sensitive issue for Deutsche Bank, which recently settled a civil tax fraud case and remains under investigation by federal prosecutors.

of the Communist Chinese government's recently issued sovereign debt obligations may be shown to have conspired with certain actors, including the Chinese government, to lend money on preferential terms and to wrongfully accept repayment of such monies on preferential terms, and which wrongful actions have had the effect of diminishing the defaulted creditors' contractual rights through the action of involuntary subordination.

The names of consignees appearing in the advance order book for the underwritten sovereign debt obligations sold by the Communist Chinese government in 2003 and in 2004 represent the lenders which subscribed the debt prior to underwriting and whose actions may be demonstrated to have had the effect of involuntary subordination, and whose actions may have created an actionable claim by defaulted creditors for injury suffered due to the legal ranking of existing debts having been altered (i.e., involuntarily subordinated) by or through the actions of another lender(s). We believe that purchasers of recently-issued and future-issued debt obligations of the government of China may have wrongfully accepted preferential payments from the government of China in exchange for wrongfully providing new money to the debtor government of China on preferential terms.[52] Our investigation into this aspect is expected to act to further enlarge the scope of the civil action presently under development.[53]

Conclusion

In conclusion, we believe that the aggressive prosecution of one or more civil actions aimed at terminating the Communist Chinese government's ability to engage in preferential and discriminatory payments to selected members of its class of general obligation creditors, in conjunction with a parallel *qui tam* action for recovery of repayment of the Chinese government's defaulted sovereign debt and recovery of damages arising from the wrongful and injurious actions of the named defendants, will not only achieve the administration of justice, but will also act to further preserve the integrity of public debt contracts and enhance financial markets discipline and transparency for all participants.

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Judicial Recovery of Defaulted Creditors' Claims

[52] Under established principles of lender liability theory, parties (e.g., recent and future purchasers of Chinese government sovereign bonds, constituted as "new lenders") which knowingly (or which can be shown to reasonably be expected to have known) provide money to a debtor on terms which act to cause injury to existing creditors in the form of an involuntary subordination of prior claims, have committed a wrongful act by providing new money on preferential terms and subsequently receiving preferential payments which have the action of depriving or diminishing the contractual rights of the prior creditors. Note further that pursuant to Section 1962(b) it is unlawful for a person to acquire or maintain an interest in an enterprise through a pattern of racketeering activity.

[53] *Query: Would an actionable claim under this theory impose liability on providers of trade credit to the Communist Chinese government for wrongfully accepting preferential payments, since such obligation is generally subordinate to full faith and credit sovereign debt?*

Exhibit A

COPY

MEMORANDUM

TO: Cynthia A. Glassman, Acting Chairman

FROM: Annette Nazareth, Director
Division of Market Regulation

RE: Summary of the American Bondholders Foundation's complaint

DATE: July 29, 2005

We received a letter dated March 31, 2005, from Sovereign Advisers on behalf of the American Bondholders Foundation ("ABF"),[1] alleging that three credit rating agencies assigned inappropriate and misleading sovereign credit ratings to the long-term foreign currency debt of the People's Republic of China. The complaint relates to bonds issued before 1949 that, according to the ABF, are now in default. The ABF asserts that these bonds, by their terms, are binding upon the government of China and its successors, but that the People's Republic of China has stated that it has no obligation to repay them.

In its complaint, the ABF states that three of the Nationally Recognized Statistical Rating Organizations ("NRSROs"), Moody's Investors Service Inc., the Standard & Poor's Division of the McGraw Hill Companies, Inc., and Fitch, Inc., have failed to conduct objective analyses of the pertinent facts and circumstances related to the long-term foreign currency debt issued by the People's Republic of China. According to the ABF, this failure resulted in the assignment of inappropriate and misleading sovereign credit ratings to this long-term foreign currency debt. The ABF also complains that misleading statements appear in the prospectus supplement for the People's Republic of China's issuance of sovereign debt in 2003. Moreover, the ABF contends that the actions it describes with respect to credit rating agencies are pertinent to the supervisory and regulatory mandate of the Division of Market Regulation with respect to the operation of the nation's securities markets generally and, specifically, the diligent enforcement of regulations governing the operation of the NRSROs.

The Commission has no express authority to regulate NRSROs as such. As was described in a recent rule proposal, the Commission has the authority to define the term NRSRO for purposes of Commission regulations.[2] The goal of the NRSRO rule proposal is to provide greater clarity and transparency to the process of determining whether a credit rating agency's ratings should be relied on as an NRSRO rating for purposes of Commission rules and regulations. The proposed definition and interpretations are intended to provide credit rating agencies with a better understanding of whether they

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1 According to the ABF, it is the incorporated national organization representing the consolidated claims of thousands of United States bondholders who are holders of full faith and credit sovereign bonds issued by the Government of China.

2 *See* Definition of Nationally Recognized Statistical Rating Organization, Release Nos. 33-8570; 34-51572; IC-26834 (April 19, 2005), 17 CFR Part 240 (April 25, 2005).

qualify as NRSROs. The Commission does not, however, have the authority to require an NRSRO to revise a debt rating classification. The NRSROs have asserted that such authority could infringe upon their First Amendment rights.

The ABF letter discusses various areas in which it believes the disclosure in offering documents was inadequate. Commission staff will use this information as we seek to ensure that issuers whose securities are registered with the Commission fulfill their responsibility to provide investors with full and fair information that is material to an investment decision.