

**SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK**

RETIREMENT PLAN FOR GENERAL
EMPLOYEES OF THE CITY OF NORTH MIAMI
BEACH and ROBIN STEIN,

Petitioners,

v.

THE MCGRAW-HILL COMPANIES, INC.,

Respondent.

)
)
) **PETITIONERS' MEMORANDUM**
) **OF LAW IN SUPPORT OF THE**
) **PETITION PURSUANT TO N.Y.**
) **C.P.L.R. ARTICLE 4**

)
) Index No. 650349/2013

)
) Hon. Jeffrey K. Oing

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I. INTRODUCTION

The books and records mechanism is a tool designed to promote judicial efficiency. One of its purposes is to make sure that trigger-happy plaintiffs do not bring shareholder derivative actions without proper investigation and thus waste the Court's time and resources. Indeed, courts have admonished shareholders for running into court at the first hint of wrongdoing to allege – without specificity – that a breach of fiduciary duty by corporate directors has caused harm to the company. Such lawsuits often lack the requisite factual basis to establish both the underlying misconduct, as well as the futility of a demand on the board. In fact, “Delaware courts have strongly encouraged stockholder-plaintiffs to utilize Section 220 [books and records demands] before filing a derivative action, in order to satisfy the heightened demand futility pleading requirements. . . .” *Paul v. China MediaExpress Holdings, Inc.*, C.A. No. 6570-VCP, 2012 WL 28818, at *5 (Del. Ch. Jan. 5, 2012). The Delaware Court of Chancery has gone so far as to apply a “fast-filer presumption” against plaintiffs who file derivative actions in a hasty manner without first investigating their claims through the books and records mechanism. *See South v. Baker*, C.A. No. 7294-VCL, 2012 WL 6114952, at *1, 18-20 (Del. Ch. Sept. 25, 2012). New York, like Delaware and most other states, provides shareholders with the tools and procedural mechanisms to request and obtain the books and records of a company in order to properly and adequately undertake such an investigation, as long as the shareholders satisfy certain criteria.

Here, the Retirement Plan for General Employees of the City of North Miami Beach (“North Miami Beach”) and Robin Stein (collectively, “Petitioners”) are trying to do just that in order to (1) make a determination of whether wrongdoing occurred at The McGraw-Hill Companies, Inc. (“McGraw-Hill” or the “Company”) that was caused by the Board of Directors’

failure to oversee the Company's Standard & Poor's Financial Services LLC ("S&P") subsidiary, resulting in breaches of fiduciary duties, and (2) make an informed decision as to whether to make a demand on the Board to take corrective action or whether such a demand would be futile. Petitioners thus made a proper written demand on McGraw-Hill pursuant to N.Y. Bus. Corp. Law § 624 and New York common law for the inspection of certain books and records (the "Demand").¹ The books and records sought by Petitioners concern McGraw-Hill's Board's oversight of S&P in connection with S&P's fraudulent credit ratings for complex financial products and lax or non-existent subsequent supervision of those same ratings for the period January 1, 2002, through the present (the "Relevant Period") – conduct which is now the subject of a lawsuit brought by the U.S. Department of Justice ("DOJ") seeking over \$6 billion in fines. At every turn, however, McGraw-Hill has done nothing but impede Petitioners' access to these materials, which Petitioners are legally entitled to under New York common and statutory law.

It is beyond dispute that the toxic mortgage-related securities that caused a nearly unparalleled financial collapse could not have been sold to investors without S&P's highest ratings, which were revealed to be unjustified, as many of these securities were subsequently downgraded by S&P, in most cases to junk grade rating. This did not escape the scrutiny of Congress or federal and state regulators. By mid-2007, McGraw-Hill and S&P were besieged by authorities, including the DOJ, the U.S. Securities and Exchange Commission ("SEC"), and the attorney general's offices for New York, Massachusetts, and Connecticut, seeking information

¹ The Demand was initially made by North Miami Beach by letter dated November 18, 2011. *See* Section II.C, *infra*. Ms. Stein joined in the Demand on June 22, 2012, and provided documentation of her ownership of McGraw-Hill stock since at least June 1997 and an executed Special Power of Attorney authorizing counsel to act on her behalf. *See* Section II.D, *infra*.

and documents related to S&P's credit-rating business. Just as damning, the United States Senate Subcommittee on Investigations also initiated a wide-ranging probe that resulted in a 600-plus page report entitled "Wall Street and the Financial Crisis: Anatomy of a Financial Collapse" (the "Senate Report"). With respect to S&P, the Senate Report concluded that "[e]vidence gathered by the Subcommittee shows that credit rating agencies were aware of the problems in the mortgage market Instead of using this information to temper their ratings, the firms continued to issue a high volume of investment grade ratings for mortgage backed securities." Indeed, since the Demand, an Australian federal court issued a 1500-page judgment that detailed how S&P misled several local councils and their financial advisor by improperly assigning its highest rating to a toxic financial product, and an Illinois state court ruled that the state's attorney general can proceed with her action alleging that S&P engaged in deceptive business practices when they assured investors of its credit ratings process. And, the DOJ recently filed a 118-page civil complaint against McGraw-Hill, seeking \$6 billion in fines for deceptive ratings S&P assigned to toxic mortgage assets.² Why would McGraw-Hill and its Board not only allow this, but encourage it? Simple – S&P's ratings business boomed during the years leading up to the financial crisis, more than doubling its revenues from \$380 million in the first quarter of 2002 to its peak of \$821 million in the second quarter of 2007.

Now, as McGraw-Hill gets called to task for S&P's conduct, its Board attempts to hide behind spurious legal arguments to shield from its own shareholders books and records they are entitled to under New York law. First, McGraw-Hill accuses Petitioners of failing to show what it believes is a "proper purpose" for their Demand. Petitioners have, however, set forth a host of

² The attorneys general of approximately sixteen states and lawyers for the District of Columbia have also filed lawsuits against S&P for violating state consumer protection and unfair trade practices laws.

proper purposes, including the investigation of mismanagement, that are uniformly recognized by this Court and others to support a request for inspection of a company's books and records. McGraw-Hill's specious argument reveals the same obstinacy that it demonstrated throughout this entire process. Moreover, Petitioners have clearly identified concrete reasons, based on undisputed facts, supporting their purposes in making the Demand. The Demand sets forth a variety of sources demonstrating wrongdoing at McGraw-Hill's S&P subsidiary, including the Senate Report, the DOJ investigation, issuance of a "Wells notice" by the SEC on the Company, and, numerous investigations by state regulators.³

Next, McGraw-Hill asserts that the Demand is overly broad and nothing more than a fishing expedition. This is just not true. As the record reflects, after several letters back and forth and several "meet and confer" conference calls over a period that spanned more than a year, Petitioners have stated several times that the requests were limited to "*documents that McGraw-Hill's Board reviewed, prepared or disseminated*" – contradicting any notion for the need to scour the Company or its S&P subsidiary and, instead, simply focusing on the members of the Board during a defined period of time.

Despite this, McGraw-Hill posits that the documents requested were not "essential and sufficient" for the purpose that inspection is sought, and repeats that it is willing to provide nothing more than limited shareholder records and annual balance sheet and profit and loss information, in addition to the annual shareholder meeting minutes it initially provided. In doing so, however, McGraw-Hill simply ignores what Petitioners are entitled to under both New York common law and Section 624, which was enacted to supplement – not supplant – a shareholder's

³ The subsequently filed judgment of the Australian federal court and the action filed by the Illinois Attorney General lend further support to the Demand.

right to the inspection of books and records under common law. To do otherwise, and agree with McGraw-Hill that the restricted set of documents it has identified are the only documents it must produce, would turn the right to inspect on its head and completely eviscerate a shareholder's right to investigate mismanagement within the corporation, as expressly permitted under law.

Petitioners respectfully request that the Court order McGraw Hill to produce its books and records, as called for in its Petition.

II. STATEMENT OF FACTS

A. S&P, The Cash Cow for McGraw-Hill

McGraw-Hill promotes S&P as “the world’s foremost provider of credit ratings.” S&P’s credit ratings – opinions “about the ability and willingness of an issuer ... to meet its financial obligations in full and on time” – are a critical tool that investors look to when making investment decisions about bonds and other fixed income products. ¶ 7.⁴ S&P does not merely rate issuers; it also addresses the credit quality of an individual debt issue and the likelihood that it may default. *Id.*

McGraw-Hill’s credit rating business escalated in the years leading up to the 2007-2008 financial crisis, taking in hundreds of millions of dollars in revenue from Wall Street. For instance, in the first quarter of 2002, McGraw-Hill reported revenue of approximately \$380 million for its Financial Services segment.⁵ ¶ 8. By the third quarter of 2005, revenues for that segment ballooned to over \$605 million, reaching a peak of \$821 million in the second quarter of

⁴ All references to the Petition Pursuant to CPLR Article 4 appear herein as “¶_”.

⁵ For the lion’s share of the Relevant Period (January 1, 2002, through the present), S&P was reported as part of McGraw-Hill’s Financial Services segment. ¶ 22 n.1. It was not until April 27, 2011, when the Company filed its Form 10-Q for the first quarter of 2011, that S&P’s financial results were reported as a separate operating segment. *Id.*

2007. *Id.* This unparalleled growth was attributable to an explosion of structured finance transactions, such as residential mortgage-backed securities (“RMBS”), collateralized debt obligations (“CDO”), and commercial-backed mortgage securities during that time period. *Id.*

The accelerated growth of S&P’s rating business for these financial instruments did not escape the notice of McGraw-Hill’s Board. Indeed, in a 2008 *Wall Street Journal* article, Harold McGraw, McGraw-Hill’s Chairman and Chief Executive, was portrayed as responsible for stressing S&P’s profit growth above all else and setting S&P’s budget. ¶ 16. *The Wall Street Journal* noted that “[b]uilding market share in existing and new products also got lots of attention [and] McGraw was a big supporter of the innovative products that S&P was rating during the boom.” *Id.* Not to be outdone by its competitors, S&P was “hungry for revenue from the tidal wave of CDOs and other complex securities flooding the market.” *Id.*

Moreover, S&P is a critical business segment of the Company, contributing more than 25% of the Company’s revenues from 2008 to 2010.⁶ ¶ 22. In fact, according to a former S&P Managing Director in charge of the RMBS Ratings Group, “[b]y 2004 the structured finance department at S&P was a major source of revenue and profit for the parent company, McGraw-Hill.” ¶ 24. Not surprisingly, in an effort to please its clients and earn repeat business (and earn hundreds of millions of dollars in fees), from 2004 through 2007, S&P provided AAA ratings to a majority of the RMBS and CDO securities issued in the U.S. *Id.*

⁶ Prior to that time, when McGraw-Hill reported S&P as part of its Financial Services segment, the Financial Services segment earned robust returns, accounting for 44% of McGraw-Hill’s revenue in 2007 and nearly 44% in 2006. ¶ 22 n.1. From 2008 to 2010, McGraw-Hill continued to report S&P as part of the Financial Services segment, and listed S&P’s revenues in the Company’s SEC filings. *Id.*

B. Indications of Problems with S&P's Aggressive Ratings

It is unquestionable that Harold McGraw's "strategy [of encouraging S&P to issue positive credit ratings, without regard to the actual quality of the instrument] led to booming profits from 2004 to 2007, [but] S&P ... now is grappling with a downside that includes lost business and regulatory inquiries about the independence of its ratings." ¶ 16. It was widely alleged in the financial press – and confirmed in the wide-ranging Senate Report – that the aggressive, optimistic credit ratings provided by S&P in connection with toxic mortgage-related securities helped trigger the global financial crisis. ¶¶ 9, 17-19.

The Senate Report, issued on April 13, 2011, included a 75-page case study on S&P's complicity in the financial crisis, which was spurred in part by widespread investments in the subprime mortgage securities market. ¶ 17. For example, the Senate Report cited internal S&P emails revealing that its analysts and senior management were well aware of increasing risks in the mortgage market, including higher risk mortgage products, lax lending standards, poor quality loans, and mortgage fraud. *Id.* The Senate Report thus concluded that "[e]vidence gathered by the Subcommittee shows that credit rating agencies were aware of the problems in the mortgage market *Instead of using this information to temper their ratings, the firms continued to issue a high volume of investment grade ratings for mortgage backed securities.*" *Id.* (emphasis added).

Significantly, while it is clear that S&P was at the center of the maelstrom, a number of exhibits to the Senate Report indicate that McGraw-Hill's senior management and the Board had knowledge of S&P's business and its practices with respect to issuing credit ratings. ¶ 19. For example, a March 3, 2007 email shows that S&P's RMBS rating division was scheduled to present to McGraw-Hill executives on the subprime situation, including with respect to ratings,

as well as how to deal with fallout from the mortgage industry. ¶ 19. Similarly, an S&P presentation and minutes from a December 5, 2007 meeting of McGraw-Hill's Board note that vintage loans during 2005 and 2006 appear to be the key problem area in the subprime situation. Ex. A to the Petition.⁷

With the unprecedented financial turmoil as a backdrop, federal and state regulators, including the DOJ, the SEC, the Massachusetts Attorney General's Office, the Connecticut Attorney General's Office, and the New York Attorney General's Office, also unleashed a torrent of investigations – all focused, at least in part, on S&P's role in the economic meltdown. ¶¶ 9-15, 20-21.⁸ These investigations ultimately uncovered rampant conflicts of interest with issuers that tainted not only the credit ratings initially issued by S&P, but also the maintenance of

⁷ All references to the exhibits attached to Petitioners' Petition Pursuant to CPLR Article 4 appear herein as "Exh. __ to the Petition, _."

⁸ On February 4, 2013, the DOJ filed a 118-page civil complaint alleging that, from 2004 through at least 2007, McGraw-Hill, through S&P, issued credit ratings for RMBS and CDO that were falsely represented as objective, independent, and free from conflicts of interest. The DOJ further alleged that these credit ratings were materially false and concealed material facts "in that S&P's desire for increased revenue and market share in the RMBS and CDO ratings markets led S&P to downplay and disregard the true extent of the credit risks posed by RMBS and CDO tranches in order to favor the interests of large investment banks and others involved in the RMBS and CDOs who selected S&P to provide credit ratings for those tranches." On the heels of the DOJ lawsuit, the attorneys general of several states also filed actions against McGraw-Hill and S&P alleging that S&P violated state consumer protection and unfair trade practices laws. For example, Maine's Attorney General alleged that McGraw-Hill and S&P misrepresented their business model and services as objective and independent and misrepresented their competence to rate certain structured financial securities. Equally troubling, California's Attorney General asserted that S&P secretly lowered its rating standards in order to gain market share in an increasingly competitive market and increase profits in its rating business. McGraw-Hill and S&P removed all of these state actions to federal court and are now seeking to have these state actions centralized in the Southern District of New York.

those ratings. ¶¶ 9, 11-14, 23. They also exposed the lax or non-existent supervision on the part of S&P of the credit ratings it had previously issued.⁹ ¶¶ 9, 23.

C. Petitioners' Demand for Books and Records

On November 18, 2011, petitioner North Miami Beach made a written demand on McGraw-Hill pursuant to N.Y. Bus. Corp. Law § 624 and New York common law for the inspection of certain books and records (the "Demand"). *See* ¶ 25; Ex. A to the Petition. The books and records sought by Petitioners were expressly identified in the Demand for the period of January 1, 2002, through the present. ¶ 26; Ex. A to the Petition. Moreover, as required by New York law, Petitioners identified numerous proper purposes, including: (i) to investigate wrongdoing, mismanagement and breaches of fiduciary duty by McGraw-Hill's Board; (ii) to assess policies, rules, guidelines, or other measures that the Board has considered and/or implemented in the past ten years to address S&P's policies and procedures for issuing credit ratings for RMBS and CDO securities; (iii) to ascertain the Board's oversight of S&P's determination to downgrade from AAA over 1000 RMBS and 100 CDO by the end of July 2007

⁹ There were at least two wide-ranging decisions related to S&P's misconduct at issue here that arose after the Demand. First, on November 5, 2012, the Federal Court of Australia issued a nearly 1500-page judgment that painstakingly described how S&P misled twelve local councils and their financial advisor by assigning its highest rating to a pair of constant proportion debt obligations ("CPDO"). ¶ 46. The Australian Court characterized S&P's ratings of the CPDO as "hopelessly deficient," noting that "[t]he CPDO could achieve a rating of AAA only on the basis of an unreasonable combination of unreasonably optimistic inputs but not otherwise." ¶ 49. Ultimately, the court found that S&P was liable to the councils and their financial advisor for negligence, negligent misstatement, and violation of various Australian statutes prohibiting the dissemination of false and/or misleading statements concerning financial products, noting that S&P's representations "were misleading and deceptive, likely to mislead and deceive and false in a material particular because the opinion was not based on reasonable grounds and S&P had not exercised reasonable care or skill in reaching the opinion." ¶ 50. Second, only two days later, on November 7, 2012, an Illinois state court ruled that the Illinois Attorney General could proceed with her claim that S&P and McGraw-Hill, as its parent company, engaged in deceptive business practices when they assured investors "that the process by which S&P rated various securities was independent, objective, and unbiased." ¶ 53.

and S&P's decision to downgrade or place on watch approximately 6300 RMBS and 1900 CDO securities on January 30, 2008; and (iv) to assess the ability of McGraw-Hill's Board to consider impartially a demand for action (including a request for permission to file a derivative lawsuit on the Company's behalf) related to the issues described in the Demand, justifying why they should be allowed to review certain, identified categories of documents from the members of the Board. ¶ 27; Ex. A to the Petition.

D. Negotiations with McGraw-Hill

After Petitioners allowed McGraw-Hill additional time to respond to the Demand, on December 9, 2011, McGraw-Hill sent a letter flatly objecting to the Demand Letter on the grounds that it was “vastly overbroad, seeking an array of documents beyond the scope of what is contemplated under Section 624 . . . and New York common law.” ¶ 30; Ex. C to the Petition. McGraw-Hill further objected on the basis that, in its view, North Miami Beach's purposes in making the Demand were “entirely speculative,” “insufficient as a matter of law to justify the sweeping demands set forth in [the] letter,” and, further, questioned the propriety of North Miami Beach's request for documents during a time period that predated its ownership of McGraw-Hill stock. ¶ 30; Ex. C to the Petition. Contemporaneous with its response, McGraw-Hill produced only the minutes of the Company's annual shareholder meetings from 2002 through 2011, a mere 53 pages. ¶ 32.

On January 6, 2012, North Miami Beach replied to McGraw-Hill asserting, among other things, that the Demand was premised on credible evidence of wrongdoing and that the materials sought were well within the scope of § 624 and New York common law. ¶ 33; Ex. D to the Petition. North Miami Beach stated that McGraw-Hill's meager response was inadequate and demanded that the deficiencies immediately be cured. ¶¶ 33, 35; Ex. D to the Petition. At the

same time, in the interest of compromise and to avoid judicial intervention, North Miami Beach reasonably offered to discuss the scope of its Demand in an attempt to narrow the disagreement concerning the categories of the requested documents. ¶ 35; Ex. D to the Petition .

On January 19, 2012, a conference call was held to determine if the parties could reach a compromise on the scope of the Demand. ¶ 36; Ex. F to the Petition. During the conference call, McGraw-Hill’s counsel reiterated its view that the request was overly broad. ¶ 36; Ex. F to the Petition. Counsel for North Miami Beach explained that McGraw-Hill had misinterpreted the Demand and clarified that it was seeking *only* those documents that the Board received, reviewed, prepared, or disseminated with respect to, among other things, (i) composition of the Board, its committees, subcommittees as well as any special committees formed to oversee S&P’s credit ratings for RMBS and CDO; (ii) McGraw-Hill’s policies and procedures regarding the Board’s oversight of S&P; (iii) investigations by the Board, its audit committee, or any special committee from 2007-2011 with respect to S&P’s compliance framework for its business operations; (iv) the independence of McGraw-Hill’s Board; and (v) policies and procedures which address and manage conflicts of interest, particularly arising out of its “issuer pays” model for issuing credit ratings. ¶ 36; Ex. G to the Petition. In other words, these documents, which pertain to the Board’s knowledge of wrongdoing at the Company’s S&P subsidiary, were readily ascertainable, obtainable, and could be produced with minimal burden. Thus, Petitioners made clear that they were seeking a limited universe of documents from a discrete set of individuals.

On February 3, 2012, McGraw-Hill sent a letter rejecting North Miami Beach’s proposal, again stating its shopworn position that the Demand failed to establish a credible basis to find probable wrongdoing and failed to identify a proper purpose. McGraw-Hill took the staunch position that it was “not prepared to supplement its production of responsive documents.” ¶ 37;

Ex. F to the Petition. On June 22, 2012, Petitioners (Ms. Stein joined the Demand on this date) sent a letter to McGraw-Hill again rejecting its baseless position and reiterated that the documents sought in each category of materials included only “*documents that McGraw-Hill’s Board reviewed, prepared or disseminated . . .*” ¶¶ 38-39; Ex. G to the Petition (emphasis in original). Petitioners again requested that McGraw-Hill cure the deficiencies in its response to the Demand, but agreed, in the spirit of cooperation, to “further discuss the scope of the Demand to avoid the need for court intervention.” ¶ 39; Ex. G to the Petition .

On July 12, 2012, McGraw-Hill sent yet another letter in which it repeated its position that Petitioners’ Demand was overbroad – notwithstanding Petitioners’ representation that the scope of the request was narrowly tailored to Board materials – and erroneously contended that counsel for Petitioners had not made any such offer to compromise during the conference call six months earlier. ¶ 40; Ex. H to the Petition. The letter concluded with an offer to discuss the production of shareholder records and annual balance sheet and profit and loss information – information that was not requested and not responsive to the Demand – and to further discuss the scope and purposes of Petitioners’ Demand. ¶ 40; Ex. H to the Petition.

On August 3, 2012, counsel for Petitioners once again responded to McGraw-Hill’s spurious arguments and attempts at delay. That letter contended both that the Demand sought “essential and sufficient” documents and that McGraw-Hill’s repeated offer to supplement its prior response with only shareholder records and annual balance sheet and profit and loss information constituted an inadequate response to the Demand. ¶ 41; Ex. I to the Petition. Finally, Petitioners once again stated that the Demand had an appropriately limited scope: “to the extent that [counsel for McGraw-Hill does] not read the Demand as limited to Board-level materials, this letter specifically reaffirms that it is.” ¶ 41; Ex. I to the Petition.

On September 6, 2012, counsel for Petitioners and McGraw-Hill once again participated in a conference call in an attempt to reach a compromise without judicial intervention. During that call, Petitioners' counsel explained that, with regard to the first four categories of documents identified in the Demand, consistent with prior correspondences, Petitioners sought only those documents regarding (i) the "flow of information" to McGraw-Hill's Board of Directors relating to S&P's business and operations, and (ii) the responsibility of McGraw-Hill's directors for oversight of S&P's business. ¶ 42; Ex. K to the Petition. Petitioners asked that McGraw-Hill produce Board presentations related to S&P, as well as the charters and by-laws of Board committees responsible for S&P oversight. ¶ 42; Ex. K to the Petition. At that point, having only gone through four categories of documents out of fifteen, counsel for McGraw-Hill tersely and abruptly ended the conversation and advised Petitioners' counsel that it would have to confer with the Company before agreeing to produce any additional documents. Incredibly, counsel for McGraw-Hill then offered an ultimatum: if McGraw-Hill produced documents *purportedly* responsive to the Demand, Petitioners would have to agree – *prior to the production and any opportunity to review the documents that would be produced* – that any such production would constitute full satisfaction of Petitioners' Demand. ¶ 42; Exs. J, K to the Petition. Petitioners rejected McGraw-Hill's absurd proposal, explaining that it would be irresponsible and unreasonable to agree that any documents produced would satisfy the Demand without first examining those documents. ¶ 42; Ex. K to the Petition.

In a letter dated September 20, 2012, counsel for McGraw-Hill purported to summarize the September 6th phone call and, ultimately, refused to comply with Petitioners' Demand for documents. The letter concluded that "[u]nder the circumstances, we cannot agree to make a supplemental production of documents beyond the materials covered by Section 624, *i.e.*,

shareholder records and annual balance sheet and profit and loss information” ¶ 43; Ex. J to the Petition.

In responding McGraw-Hill’s September 20th letter, Petitioners sent a letter on October 2, 2012, criticizing counsel for mischaracterizing the September 6th phone call, particularly with regard to McGraw-Hill’s ultimatum. ¶ 44; Ex. K to the Petition. Counsel for Petitioners explained that, logically, they could not agree to such a request “without reviewing the production to determine whether, in fact, the Company produced the responsive books and records, a position we believe is more than reasonable.” ¶ 44; Ex. K to the Petition. Petitioners concluded that because “the Company is refusing to permit inspection and copying of the demanded documents, we are forced to pursue alternative appropriate legal and equitable remedies including, but not limited to, filing a complaint in the New York State Supreme Court.” ¶ 44; Ex. K to the Petition. This action followed.

III. ARGUMENT

A. Legal Standards

New York state courts have long upheld the right of shareholders to inspect the books and records of a corporation. *See Matter of Steinway*, 159 N.Y. 250, 264-5 (1899). Indeed, under New York law, a shareholder has both statutory and common-law rights to inspect books and records of a corporation if inspection is sought in good faith and for a valid purpose. *Matter of Peterborough Corp. v. Karl Ehmer, Inc.*, 215 A.D.2d 663, 664 (N.Y. App. Div. 1995); *Matter of Crane Co. v. Anaconda Co.*, 39 N.Y.2d 14, 19 (N.Y. 1976); *Malone v. Dimco Corp.*, 68 Misc.2d 610, 612 (N.Y. Sup. Ct. 1969).

1. Request for Books & Records Under NY Bus. Corp. Law § 624

N.Y. Bus. Corp. Law § 624 affords a shareholder the right to examine certain books and records of a corporation upon demand. “The statutory right of inspection provides a minimum threshold which a shareholder must meet in order to be entitled to inspect the materials in issue. That is to say, if a shareholder meets these minimum requirements, and requests the information in good faith, the court has no choice but to grant the inspection request. The shareholder has an absolute right to the information.” *Rockwell v. SCM Corp.*, 496 F. Supp. 1123, 1126 (S.D.N.Y. 1980). Moreover, the statute should be liberally construed in favor of the stockholder. *In re Casacci*, 13 Misc. 3d 1232(A) (N.Y. Sup. Ct. 2006) *aff’d*, 35 A.D.3d 1285 (N.Y. App. Div. 2006).

2. Request for Books & Records Under NY Common Law

Any stockholder has a common law right to inspect a company’s books and records if the inspection is sought in good faith and for a valid purpose. *Dwyer v. DiNardo & Metschl, P.C.*, 41 A.D.3d 1177, 1179 (N.Y. App. Div. 2007) (citing *Matter of Peterborough*, 215 A.D.2d at 664); *Sivin v. Schwartz*, 22 A.D.2d 822 (N.Y. App. Div. 1964); *Weisfeld v. Spartans Industries, Inc.*, 58 F.R.D. 570 (S.D.N.Y. 1972). Notably, it is the corporation that bears the burden to show bad faith or an improper purpose under the common law. *Matter of Dyer v. Indium Corp. of Am.*, 2 A.D.3d 1195 (N.Y. App. Div. 2003); *De Paula v. Memory Gardens*, 90 A.D.2d 886, 887 (N.Y. App. Div. 1982); *Troccoli v. L&B Contract Industries, Inc.*, 259 A.D.2d 754, 755 (N.Y. App. Div. 1999); *Malone*, 68 Misc. 2d at 612. Indeed, the common law right of inspection is broader than the statutory right and § 624 was enacted simply to supplement those rights. *Rockwell*, 496 F. Supp. at 1126. This broad right to inspect includes those documents, records,

and information relevant and necessary to proper purposes. *Matter of Liaros v. Ted's Jumbo Red Hots, Inc.*, 96 A.D.3d 1464 (N.Y. App. Div. 2012); *see also Dwyer*, 41 A.D.3d at 1179.

As previously mentioned, derivative plaintiffs in other jurisdictions, such as Delaware, are strongly encouraged to employ the books and records mechanism before filing suit. *See Paul*, 2012 WL 28818, at *5; *Brehm v. Eisner*, 746 A.2d 244, 266-67 (Del. 2000). Delaware jurisprudence, for instance, reveals a steady stream of shareholder derivative actions that are dismissed because the plaintiff has sued before investigating the company's books and records. *See La. Mun. Police Employees' Ret. Sys. v. Pyott*, 46 A.2d 313, 343-44 (Del. Ch. 2012).

B. Petitioners' Request Was Made in Good Faith and for a Number of Proper Purposes

As set forth in their Demand, Petitioners have made a Demand in good faith and for a number of valid purposes which are "reasonably related to the shareholder's interest in the corporation." *Matter of Tatko v. Tatko Bros. Slate Co.*, 173 A.D.2d 917 (N.Y. App. Div. 1991).

It is well-settled that proper purposes "include, among others, efforts to ascertain the financial condition of the corporation, . . . *to investigate management's conduct*, and to obtain information in aid of legitimate litigation" *Tatko*, 173 A.D.2d at 918 (emphasis added); *cf. Sanders v. Ohmite Holding, LLC*, 17 A.3d 1186, 1193 (Del. Ch. 2011) (under Delaware law, valuing one's ownership interest and investigating potential wrongdoing are proper purposes); *La. Mun. Employees Ret. Sys. v. Morgan Stanley & Co.*, Civ. A. 5682-VCL, 2011 WL 773316, at *7 (Del. Ch. Mar. 4, 2011) (under Delaware law, demand to inspect corporate books and records to investigate legitimacy of board of directors' decision to refuse lawsuit demand was a proper purpose); *Pershing Square, L.P. v. Ceridian Corp.*, 923 A.2d 810, 818 (Del. Ch. 2007) (under Delaware law, investigating the suitability of corporation's directors is a proper purpose); *Seinfeld v. Verizon Communications, Inc.*, 909 A.2d 117, 121 (Del. 2006) (Under Delaware law,

it is “well established that a stockholder’s desire to investigate wrongdoing or mismanagement is a ‘proper purpose.’”); *Thomas & Betts Corp. v. Leviton Mfg. Co., Inc.*, 681 A.2d 1026, 1031 (Del. 1996) (under Delaware law, investigation of waste and mismanagement is a proper purpose for a books and records inspection).

Here, Petitioners have raised a number of proper purposes for their Demand including, among others: to investigate wrongdoing and mismanagement of the Company by the Board of Directors and Senior Management involving their oversight of S&P; to assess the Board’s ability to consider impartially a demand for action; to evaluate any guidelines that the Board has considered in the past ten years to address S&P’s policies and procedures for issuing credit ratings for RMBS and CDO securities; to ascertain the Board’s process in reaching decisions concerning S&P’s policies towards fees charged to issuers of RMBS and CDO securities; and to explore remedial corporate governance measures up to and including legal action. *See, e.g.*, ¶ 27; Ex. A to the Petition. McGraw-Hill has pointed to no authority calling into question the propriety of these purposes because it cannot: the Appellate Division specifically condoned such purposes in *Tatko, supra*. Rather, McGraw-Hill appears to believe that repeatedly rejecting Petitioners’ stated purposes as “improper” will make it so. It will not.

Further, Petitioners have clearly identified concrete reasons supporting their proper purposes in making a Demand for the Company’s books and records. McGraw-Hill also cites to Delaware law for the proposition that Petitioners must provide a “credible basis to find probable wrongdoing.” However, neither § 624 nor New York common law appear to require any specific quantum of proof and New York courts have merely held that requests for corporate books and records may not be based on “speculative purposes.” *Crane Co.*, 39 N.Y.2d at 19 (internal quotation marks and citation omitted); *see also Lapsley v. Sorfin Int’l, Ltd.*, 843

N.Y.S.2d 141, 142 (App. Div. 2007) (a request for inspection of a corporation's books and records "may not be based upon unsupported claims"). Petitioners have amply met this standard. The Demand, and in Petitioners' repeated correspondences with McGraw-Hill, have identified a variety of sources evincing wrongdoing at McGraw-Hill and, specifically, at its S&P subsidiary, including the findings in the Senate Report, the issuance of a "Wells Notice" by the SEC, and numerous investigations by state and federal regulators. *See, e.g.*, ¶¶ 9-24; Ex. A to the Petition. Importantly, the Senate Report expressly concluded that S&P was complicit in the financial crisis, citing internal S&P emails revealing that S&P analysts and senior management continued to provide top ratings to various financial products despite their keen awareness of increasing risks in the mortgage market, including higher risk mortgage products, lax lending standards, poor quality loans, and mortgage fraud. *See, e.g.*, ¶¶ 17-19; Ex. A to the Petition. Thus, it is beyond dispute that Petitioners' concerns are neither "speculative" nor "unsupported."

Even if this Court were to look to Delaware's "credible basis" standard as persuasive authority, the result would not change.¹⁰ "Although the threshold for a stockholder in a Section

¹⁰ In its February 14, 2013 letter to the Court, McGraw-Hill asserts that a shareholder must establish "a credible basis to find probable wrongdoing on the part of corporate mismanagement" to obtain records under Section 624. *See In re Forest Laboratories, Inc. Derivative Litig.*, 450 F. Supp. 2d 379, 393 (S.D.N.Y. 2006). There, however, the court recognized that "wrongdoing itself need not be proved." *Id.* In fact, in direct contrast to McGraw-Hill's position, the court recognized "repeated admonitions...for derivative plaintiffs to proceed deliberately and to *use the books and records to gather the materials necessary to prepare a solid complaint.*" *Id.* (emphasis added). As a result, shareholders are entitled to documents that go beyond the mere meeting minutes of the board. *Id.* ("It is also common for such shareholder requests to include demands for all financial records relating compensation paid to directors, specific data pertaining to the company's manufacturing, operations, product lines, and industry."). Similarly, McGraw-Hill's reliance on *Teamsters v. Harold McGraw III*, 09 Civ. 140 (PGG), 2010 WL 882883 (S.D.N.Y. March 11, 2010) is equally misplaced and cuts directly against the rationale of *Forest Laboratories*. First, the *Teamsters* action was commenced and dismissed *before* some of the critical facts provided by Petitioners in support of their Demand emerged, such as the Senate Report and the Wells Notice from the SEC. There is also no indication that the plaintiff in the *Teamsters* action submitted a demand pursuant to Section 624 or New York common law like Petitioners did here. Not only is this

(footnote cont'd on next page)

220 [books and records] proceeding is not insubstantial, the ‘credible basis’ standard sets the lowest possible burden of proof. The only way to reduce the burden of proof further would be to eliminate any requirement that a stockholder show *some evidence* of possible wrongdoing.” *Seinfeld*, 909 A.2d at 123 (emphasis in original). “[T]he threshold may be satisfied by a credible showing, through documents, logic, testimony or otherwise, that there are legitimate issues of wrongdoing.” *Sec. First Corp. v. U.S. Die Casting & Dev. Co.*, 687 A.2d 563, 568 (Del. 1997). To the extent that the “credible basis” standard imposes a greater burden than is required under New York law, that standard is easily satisfied here. Indeed, Delaware courts have found the existence of a credible basis in the face of less evidence than that identified by Petitioners. *See, e.g., Carapico v. Phila. Stock Exchange, Inc.*, 791 A.2d 787, 792 (Del. Ch. 2000) (investigating misconduct implicated in an SEC inquiry “is sufficiently concrete”); *see also Cohen v. El Paso Corp.*, No. Civ.A. 551-N, 2004 WL 2340046, at *2 (Del. Ch. Oct. 18, 2004) (SEC investigation and significant write-down resulting from improper accounting provide a credible basis for investigating corporate waste and mismanagement) (unpublished opinion); *Freund v. Lucent Techs.*, No. Civ. A. 18893, 2003 WL 139766, at *3 (Del. Ch. Jan. 9, 2003) (SEC investigation, company’s revision of its financial statements, and litigation by other shareholders “adequately supplies ‘some credible basis’ to support an inference of waste or mismanagement”). Thus, Petitioners have established both proper purposes for inspecting McGraw-Hill’s books and records and provided concrete evidence underlying those purposes.

against the guidance of *Forest Laboratories*, but the failure of the *Teamsters* plaintiff to use all available methods of investigation before assessing the need for litigation and filing a complaint does not mandate that Petitioners should be foreclosed from using those methods in investigating the purposes for its Demand going forward.

C. Petitioners' Request for Board-level Materials was Narrowly Tailored to Obtain Only "Essential and Sufficient" Documents

Under New York law, the “scope of the inspection right is broad” and includes “documents which in the trial court’s exercise of reasonable discretion the situation requires be reviewed.” *Tatko*, 173 A.D.2d at 919. In its various letters, McGraw-Hill seeks to portray Petitioners as unreasonable and “seek[ing] an array of documents beyond the scope of what is contemplated.” In fact, McGraw-Hill has made it abundantly clear that it was only willing to provide, as required under Section 624, nothing more than shareholder records and annual balance sheet and profit and loss information (in addition to the annual shareholder meeting minutes it initially provided). *See, e.g.*, ¶¶ 32, 37, 43; Exs. C, F, J to the Petition. This position is wholly untenable and misconstrues Petitioners’ Demand to rely solely on Section 624, ignoring the fact that Petitioners are seeking books and records under both the New York statutory *and* common law. While Petitioners’ requests are reasonable under either means, the “common law right of inspection is much broader than the statutory right, particularly in the case of non-financial records.” Arthur A. Russ, Shareholders’ Right to Inspect Corporation’s Books and Records Goes Beyond Statutory Language, NY CLS Bus. Corp. § 624 (LEXIS 2012), attached hereto as Roseman Decl. Ex. A.¹¹ In fact, “courts will allow shareholders to inspect any corporate documents, whether or not financial.” *Id.* Thus, the Court should reject McGraw-Hill’s attempt to impermissibly limit the scope of Petitioners’ Demand. To do otherwise would eviscerate a shareholder’s right to evaluate the conduct of a company and render the “right to inspection [] wholly illusory if the corporation was permitted to decide which of its records

¹¹ References to “Roseman Decl. Ex. ___” are to the exhibits attached to the accompanying Declaration of Robert M. Roseman submitted in support hereof.

members were allowed to see.” *Wells v. League of Am. Theatres & Producers, Inc.*, 183 Misc. 2d 915, 920, 706 N.Y.S.2d 599, 604 (Sup. Ct. 2000) (evaluating a demand under Not-For-Profit analogue to Section 624).¹²

Petitioners’ Demand is necessarily “limited to what is essential and sufficient to accomplish a specific stated purpose[.]” *Yusufzai v. Owners Transport Comm., Inc.*, 856 N.Y.S.2d 504, 2008 N.Y. Slip Op. 50216(U), at *3 (N.Y. Sup. Ct. 2008) (interpreting Delaware law); *see also Liaros v. Ted's Jumbo Red Hots, Inc.*, 96 A.D.3d 1464 (N.Y. App. Div. 2012) (“right of inspection should be limited to *those documents, records, and information* relevant and necessary to his proper purposes”) (emphasis added).¹³ Importantly, when one of the articulated goals of the books and records request is evaluating a possible derivative suit, like here, “the books and records that satisfy the action are those that are required to prepare a well-pleaded complaint.” *Kaufman v. CA, Inc.*, 905 A.2d 749, 753 (Del. Ch. 2006) (defendant provided “a wide range of highly probative documents, including lightly redacted notes of all board meetings from the entire period in which any misconduct could have occurred, internal

¹² *See also Leisner v. Kent Investors Inc.*, 62 Misc. 2d 132, 135, 307 N.Y.S.2d 293, 296 (Sup. Ct. 1970) (“[The] corporations are directed to supply the petitioner with their annual balance sheet and profit and loss statement for the preceding fiscal year, if any, *and* to permit inspection of their books of account, contracts and correspondence.”) (emphasis added); *Espinoza v. Hewlett-Packard Co.*, 32 A.3d 365, 369 (Del. 2011) (company offered to provide “Board meeting minutes, the Allred letter, expense reports, internal ‘conflict of interest’ and expense reimbursement guidelines, and records of compensation provided to Fisher for ‘events, meals, and meetings with Mr. Hurd’” in response to a request for books and records); *Dekalb County Pension Fund v. Google, Inc.*, C.A. No. 6993 (Del. Ch.) (2/29/12 Tr. on Defendant’s Motion for Summary Judgment and Rulings of the Court at 40) (court ordered defendant to produce materials “provided or presented” to current or former directors of the Google board, and to not limit the production to just formal meetings of the board or board committees, and to include materials provided or presented by third parties, Google employees, *etc.*). *See* Roseman Decl. Ex. B.

¹³ *See also Sanders v. Ohmite Holdings, LLC*, 17 A.3d 1186, 1194 (Del. Ch. 2011), *judgment entered sub nom. Sanders v. Ohmite Holding, LLC* (the core inquiry in a books and records action is whether the requested documents are “reasonably required to satisfy the purpose of the demand”).

documents laying out [defendant's] legal strategy, [its counsel's] talking points to present to the government, and even summaries of interviews conducted with central figures in the fraud.”¹⁴

As discussed above, Petitioners have established a number of proper purposes for their Demand – chief among them, investigating mismanagement of McGraw-Hill by its Board for its failure to properly oversee the management of the Company and in particular, S&P. As a result, on several occasions, Petitioners confirmed that the Demand was aptly seeking only a discrete category of *documents that McGraw-Hill's Board reviewed, prepared or disseminated within each category of materials sought* which relate directly to the Board's oversight of S&P. *See, e.g., ¶¶ 39, 39, 41-42; Exs. G, I, K to the Petition.* In other words, Petitioners' Demand seeks a *limited number of documents related to specifically identifiable categories from a defined number of individuals, i.e., McGraw-Hill's Board members, during a discrete time period.* These categories of documents include, among others, Board, committee, and special committee meeting minutes; charters of the Board's committees or any special committees; Board documents and presentations that reference S&P's credit ratings of RMBS and CDOs or conflicts of interest arising out of S&P's "issuer pays" model; presentations to the Board by S&P or third parties concerning S&P's market share for rating RMBS and CDO; documents related to investigations by the Board or any of its committees conducted in 2007-2012 concerning S&P's compliance framework for its business operations; and memorandums and forms related to any

¹⁴ *See, e.g., Romero v. Career Educ. Corp.*, No. Civ.A. 793-N, 2005 WL 1798042, at *1 n.1 (Del. Ch. Jul. 19, 2005) (seeking all memoranda, presentations, reports, minutes, etc. for several bases including, detecting violations of the company's code of conduct and ethics codes and investigations related to wrongdoing related to student enrollment, retention and graduation); *Khanna v. Covad Communications Group, Inc.*, No. 20481-NC, 2004 WL 187274, at *8-10 (Del. Ch. Jan. 23, 2004) (approving, with some limitations, ten out of fourteen categories of documents in plaintiff's demand); *Freund*, 2003 WL 139766, *5-7 (approving most of the eighteen categories of documents sought by plaintiff pursuant to his Section 220 request).

policies of the Company regarding director independence of the members of the Company's Board. See attached Schedule A, which sets forth all the categories of documents which Petitioners have voluntarily agreed to narrow. Each of these categories of documents will enable Petitioners to determine whether in fact the directors breach their fiduciary duties in failing to properly oversee S&P, which caused harm to the Company, and whether making a demand on the Board to take corrective action is futile. If Petitioners were seeking discovery from the Company, as McGraw-Hill suggests, the requests would not be limited only to what the Board reviewed, prepared, or disseminated, but would seek documents from McGraw-Hill's and S&P's executive officers and employees for broader categories of documents, including materials turned over to Congress and federal and state regulators.

While it is clear that Petitioners' Demand does not seek the production of documents equivalent to that of a discovery request in a shareholder derivative action, "where a plaintiff has shown evidence of wide-ranging mismanagement or waste, a more wide-ranging inspection may be justified." *Freund*, 2003 WL 139766, at *4 (allowing the plaintiff to inspect materials in response to several categories of requests); see also *Saito v. McKesson HBOC, Inc.*, 806 A.2d 113, 117 (Del. 2002) ("books and records from the inception of the alleged wrongdoing could be necessary and essential to the stockholder's purpose"). Thus, it is incontrovertible that Petitioners have voluntarily narrowed their proper document requests to those materials that are in line with both the scope and timing essential and sufficient to, among other things, investigate corporate mismanagement.

IV. CONCLUSION

For the foregoing reasons, Petitioners respectfully request that the Court enter an order directing respondent, The McGraw-Hill Companies, Inc. to produce and permit the Petitioners

and their attorneys to inspect, examine, and copy the books, records, and papers of The McGraw-Hill Companies, Inc., as set forth in the attached Schedule A; to make photostatic copies or other reproductions thereof; and to afford all necessary facilities for such inspection and copying at such times and places that may be designated by the Court, without interference on the part of respondent, its agents, representatives, and employees.

Dated: March 22, 2013

Respectfully submitted,

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SCHEDULE A

All books, records, and documents that were reviewed by, prepared by or for, or disseminated to or among the Board of Directors ("Board") of The McGraw-Hill Companies, Inc. ("McGraw-Hill" or the "Company") and any committee or subcommittee ("Committee") thereof during the period of January 1, 2002 through the present ("Relevant Period"), relating to the following categories:

1. The composition of the Board, all Board Committees with oversight responsibilities of Standard & Poor's Financial Services LLC ("S&P"), and any special committees ("Special Committees") formed to oversee and/or investigate S&P credit rating services for Residential Mortgage-Backed Securities ("RMBS") and Collateralized Debt Obligations ("CDO"), including, but not limited to: (i) charters for each Committee and Special Committee; (ii) organizational charts and flow charts which would indicate names, positions, reporting responsibilities, and/or employment titles; (iii) the identification of S&P senior level employees who report directly to the Board and/or McGraw-Hill senior level employees who report directly to the Board regarding S&P's business and operations; and (iv) policies and procedures, instruction manuals, guides and, checklists.
2. For the Board, all Board committees with oversight responsibilities of S&P, and all Special Committees formed to oversee and/or investigate S&P's credit rating services for RMBS and CDO: (i) Board minutes, Committee minutes, and Special Committee minutes; and (ii) reports, and memorandums, summaries, recommendations, and other documents relating to the S&P's downgrade of over 1000 RMBS and 100 CDO by the end of July 2007 and the decision to downgrade or place on credit watch approximately 6300 RMBS and 1900 CDO securities on January 30, 2008.
3. The independence of the members of the Board, including all books and records concerning any potential or actual conflict of interest of any such member, any policies of the Company regarding director independence and/or conflicts of interest, and any memoranda or forms provided to and/or submitted by any of the Company's directors.
4. S&P's business and operations, including, for example, results of operations, Board books, policies and procedures, manuals, and presentations or reports by S&P executives and employees to the Board or any Committee or Special Committee.
5. Any and all investigations, reviews, and analyses by the Board, any Committee (including the Audit Committee), and any Special Committee relating to S&P's issuance of credit ratings for RMBS and CDO conducted or prepared during the period 2007 through 2012, including, for example, presentations, meeting minutes, notes, and any conclusions and/or recommendations made in connection therewith.
6. S&P's market share with respect to its ratings of RMBS and CDO securities; all plans, proposals, and recommendations for increasing S&P's market share for rating RMBS and CDO securities; and documents submitted to the Board or any Committee thereof relating

to compensation policies as they relate to (i) increases in S&P's market share, and/or (ii) the ratings, or any changes thereon, issued by S&P on RMBS and CDO securities, which were submitted to or discussed at meetings of the Board, any Special Committee, or any other Committee.

7. Any modifications or potential modifications to S&P's policies and procedures for issuing credit ratings for RMBS and CDO securities, and any documents regarding the monitoring of credit ratings following enactment of the U.S. Credit Rating Agency Reform Act on September 29, 2006 or the U.S. Securities and Exchange Commission's ("SEC") Proposed Rules for Nationally Recognized Statistical Rating Organizations, revised and adopted in February 2009; this includes any and all revisions to policies and procedures, manuals or guides, and any changes in reporting responsibilities or job descriptions.
8. The costs incurred by the Company as a consequence of any governmental or regulatory inquiry including, but not limited to, the U.S. Senate Subcommittee on Investigations, any civil and/or criminal investigations, administrative or regulatory reviews, enforcement actions and lawsuits by any governmental or regulatory body including the SEC, U.S. Department of Justice, federal prosecutor's office and/or any state attorney general or other U.S. federal or state or any Australian governmental authority, and private civil lawsuits pertaining to S&P's ratings of RMBS and CDO securities.
9. Any books and records demand from any other McGraw-Hill shareholder pertaining to S&P's ratings of RMBS and CDO securities, including, for example, demand letters, meeting minutes, and any reports to the Board or any Committee or Special Committee regarding any such demand.