

# ClientAlert

## Commercial Litigation

January 2012

### New York Court of Appeals' Clarification of the Martin Act Opens Door for Common Law Claims in Securities Cases

The New York Court of Appeals recently held that the Martin Act<sup>1</sup>—New York's "Blue Sky" law—does not preclude private plaintiffs from pursuing common law claims such as fraud and negligent misrepresentation relating to securities transactions. In *Assured Guar. (UK), Ltd. v. J.P. Morgan Inv. Mgmt., Inc.*,<sup>2</sup> the Court (New York's highest court) unanimously held that breach of fiduciary duty and gross negligence claims tied to alleged mismanagement of an investment portfolio are not barred by the Martin Act. This decision represents an important clarification of New York law and significantly expands the ability of private parties to assert common law claims against financial institutions and other parties in securities-related actions under New York law.

#### Background: The Longstanding Debate Over the Scope of the Martin Act

Assured Guaranty ("Assured") brought claims against J.P. Morgan Investment Management ("J.P. Morgan") as a third-party beneficiary to an investment management agreement between J.P. Morgan and Orkney Re II PLC ("Orkney"). Assured claimed J.P. Morgan mismanaged Orkney's investment portfolio, which was guaranteed by Assured. Assured alleged that J.P. Morgan invested Orkney's assets in high-risk mortgage-backed securities without disclosing the true risks of those investments and made investment decisions in favor of another J.P. Morgan client instead of Orkney.

Assured sued J.P. Morgan in New York Supreme Court, asserting common law claims for breach of fiduciary duty, gross negligence and breach of contract. J.P. Morgan sought to dismiss Assured's common law claims as preempted by the Martin Act, which "authorizes the [New York] Attorney General to investigate and enjoin fraudulent practices in the marketing of stocks, bonds and other securities within or from New York."<sup>3</sup> The trial court granted J.P. Morgan's motion to dismiss, holding that "the claims for breach of fiduciary duty and gross negligence fall within the purview of the Martin Act and their prosecution by plaintiff would be inconsistent with the Attorney General's exclusive enforcement powers under the Act."<sup>4</sup>



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1. N.Y. Gen. Bus. Law §§ 352-59 (McKinney 2011).

2. 2011 N.Y. Slip Op. 09162 (N.Y. Dec. 20, 2011).

3. *Assured Guar. (UK) Ltd. v. J.P. Morgan Inv. Mgmt., Inc.*, 80 A.D.3d 293, 298 (N.Y. App. Div. 2010).

4. *Assured Guar. (UK) Ltd. v. J.P. Morgan Inv. Mgmt., Inc.*, No. 603755/08 (BRK), 2010 WL 2977934, at \*5 (N.Y. Sup. Ct. Jan. 28, 2010).

The Appellate Division reversed, concluding that “there is nothing in the plain language of the Martin Act, its legislative history or appellate-level decisions in this State that supports defendant’s argument that the act preempts otherwise validly pleaded common law causes of action.”<sup>5</sup> The disagreement between the trial court and Appellate Division reflected a broader and longstanding dispute among New York state and federal courts as to whether common law claims arising out of facts that might support a Martin Act claim by the New York Attorney General are barred in actions brought by private litigants.

### The Court of Appeals Clarifies the Scope of the Martin Act

In a unanimous decision, the Court of Appeals affirmed the Appellate Division and held that Assured’s claims for breach of fiduciary duty and gross negligence were not barred by the express terms of the Martin Act, nor the Act’s legislative history or purpose, nor the prior decisions of the Court of Appeals.

The Court noted that, in authorizing the Attorney General to investigate and enjoin certain fraudulent practices, the Martin Act was “enacted ‘to create a statutory mechanism in which the Attorney General would have broad regulatory and remedial powers to prevent fraudulent securities practices.’”<sup>6</sup> But the Martin Act, by its terms, “does not expressly mention or otherwise contemplate the elimination of common law claims.”<sup>7</sup> Indeed, after reviewing the legislative history of the statute, the Court found that “the Martin Act, as it was originally conceived... did not evince any intent to displace all common law claims in the securities field” and further concluded that such intent was not evident from any of the subsequent changes in the law.<sup>8</sup>

The Court then distinguished two prior decisions which had been used to argue for Martin Act preemption.<sup>9</sup> After reviewing those cases, the Court concluded that they only stood for the more limited idea that a private plaintiff may not assert a “common law cause of action where the claim is predicated solely upon a violation of the Martin Act or its implementing regulations and would not exist but for the statute.”<sup>10</sup> As such, “an injured investor may bring a common law claim (for fraud or otherwise) that is not entirely dependent on the Martin Act” because “[m]ere overlap between the common law and the Martin Act is not enough to extinguish common law remedies.”<sup>11</sup>

The Court reasoned that its decision would not undermine the Attorney General’s powers under the Martin Act because common law actions by private plaintiffs “further the same goal [as the Attorney General’s powers]—combating fraud and deception in securities transactions.”<sup>12</sup> Indeed, precluding common law actions would likely leave markets less protected, which would be inconsistent with the purpose of the Martin Act.<sup>13</sup>

### Implications: A New Route for Plaintiffs in Securities Actions

Based on *Assured Guaranty*, private plaintiffs may pursue common law fraud and misrepresentation claims in New York state courts in securities cases without fear of Martin Act preemption. Given the recent trend of private plaintiffs seeking to avoid the heightened pleading standards in federal securities and class actions, this decision is likely to be seen as offering a new and favorable route for common law claims against financial institutions or with respect to securities marketed, sold or listed in New York.

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5. *Assured Guar. (UK) Ltd.*, 80 A.D.3d at 304.

6. *Assured Guar. (UK) Ltd.*, 2011 N.Y. Slip Op. 09162, at \*4 (quoting *CPC Int’l v. McKesson Corp.*, 70 N.Y.2d 268 (1987)).

7. *Id.* at \*4.

8. *Id.*

9. *Id.* at \*7 (citing *CPC Int’l*, 70 N.Y.2d 268; *Kerusa Co. LLC v. W10Z/515 Real Estate Ltd. P’ship*, 12 N.Y.3d 236 (2009)).

10. *Id.* at \*10 (emphasis added).

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11. *Id.*

12. *Id.*

13. *Id.*

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