

NEW YORK COURT OF APPEALS HOLDS THAT MARTIN ACT DOES NOT PREEMPT PRIVATE COMMON-LAW CAUSES OF ACTION

December 23, 2011

To Our Clients and Friends:

On December 20, 2011, New York's highest court held unanimously that private parties can sue for alleged wrongdoing in connection with securities transactions so long as the claims are not wholly duplicative of, or do not arise from, a violation of New York's Martin Act. Prior to this decision, the view of many lower courts and practitioners had been that because the Martin Act vests the New York Attorney General with sole enforcement authority over securities fraud and related practices, overlapping private non-fraud tort claims in the securities field were preempted. The opinion by the New York Court of Appeals in *Assured Guaranty (UK) Ltd. v. J.P. Morgan Investment Management Inc.* affirms the First Department's holding that the Martin Act does not preempt common law causes of action that are "not entirely dependent on the Martin Act for [their] viability."

The case centered on allegations by bond insurance company Assured Guaranty (UK) Ltd. against J.P. Morgan Investment Management Inc. regarding its management of the investment portfolio of Orkney Re II PLC, whose obligations Assured had guaranteed. Assured, as a third-party beneficiary of the investment agreement between Orkney and J.P. Morgan, asserted claims for breach of fiduciary duty and gross negligence. J.P. Morgan argued that the Martin Act preempts common law tort claims that overlap with the fraudulent securities and investment practices covered by the statute, over which the New York Attorney General has exclusive authority.

The Court held that independently viable private causes of action are not preempted by the Martin Act, even if such claims may overlap with Martin Act violations. In reaching this conclusion, the Court focused on both the language and the legislative history of the Martin Act. Further, the Court noted that this decision is not a departure from previous decisions and is in line with policy considerations. While the Court did not recognize a private right of action for violations of the Martin Act, its holding regarding the availability to private parties of common-law tort claims previously believed to be preempted will likely result in additional litigation.

THE COURT'S ANALYSIS

The Court's analysis began with the plain language and legislative intent of the Martin Act. The Court explained that the State legislature's previous expansions of the Martin Act's original scope -- from a weapon the Attorney General could use to seek only injunctive relief in security fraud matters, to a grant of authority to also seek criminal proceedings and obtain monetary restitution in both securities and real estate matters -- contain no language explicitly eliminating common-law claims. The Court found that there is no explicit language or a "clear and specific" legislative mandate that the Martin Act abolished preexisting common-law claims available to private parties.

The Court explained that previous decisions established only that "a private litigant may not pursue a common-law cause of action where the claim is predicated solely on a violation of the Martin Act or its implementing regulations and would not exist but for the statute." As to claims not founded in violations of the Martin Act requirements, an injured party can bring a common-law claim for fraud (or otherwise). Lastly, the Court agreed with the Attorney General, who filed an amicus brief in the case, that the Act's purpose would not be undermined by private common-law actions finding basis on grounds independent from the Act.

The Court's decision comes just shy of a year after the U.S. District Court for the Southern District of New York declined to follow the First Department's ruling in this matter,¹ noting that the First Department's decision was a shift from previous cases and was not the ultimate decision on the matter. The Court has now made it clear that private rights of action for independently viable common-law torts are not preempted by the Martin Act.

THE *ASSURED* DECISION WILL YIELD AN INCREASE IN PRIVATE SECURITIES CLAIMS

The *Assured* decision will open the door for private parties to bring viable common-law claims for actions previously thought to be under the exclusive purview of the Attorney General's enforcement regime under the Martin Act. Short of legislative changes to the Martin Act, we believe this decision to be the last word on the issue -- both for New York State courts and for federal courts applying New York law. With the availability of private causes of action for common-law torts in the securities and investment practices arenas, companies and individuals should anticipate a significant increase in private litigation.

¹ *In re J.P. Jeanneret Associates*, 769 F. Supp. 2d 340 (S.D.N.Y. 2011).

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