Court Applies California Common Law To New York Rating Agencies

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In another auction rate securities (ARS) case, The Anschutz Corporation (TAC) brought suit against several rating agencies alleging negligent misrepresentation. *The Anschutz Corp. v. Merrill Lynch & Co.,* Fed. Sec. L. Rep. (CCH) P96,258 (N.D. Cal. March 27, 2011). District Judge Susan Illston's opinion is interesting because she tackles the question of whether California or New York law should apply. Moreover, her decision to apply California law may influence plaintiffs' attorneys to file their cases here.

The plaintiff argued that California law should apply because the plaintiff's agent had purchased the ARS in California and California has a significant interest in having its laws applied. The rating agencies argued that New York law should apply because they are located in New York and they disseminated their ratings from New York. Judge Illston suggested that the rating agencies favored New York law because they believed that the Martin Act preempts common law negligent misrepresentation claims.

Judge Illston decided that the issue should be decided by applying the choice of law rules of the forum state (California). California applies the following three-part analysis to determine whether to apply California or non-forum law should apply:

- Do the laws of each jurisdiction differ?
- If the laws do differ, is there a "true conflict" (*i.e.,* each jurisdiction has an interest in having its laws applied)?
- If a true conflict exists, which jurisdiction's law would be most impaired?

Both sides admitted that the elements of a negligent misrepresentation claim under each state's laws differed and that those differences created a "true conflict". Thus, Judge Illston had to determine which state's law would be most impaired. The rating agencies argued that they expected New York law to apply because that is where they carried out their activities. They also argued that New York law has acted to protect the free flow of information. The court, however, concluded that because the rating agencies publish their ratings nationwide, they could not have a reasonable expectation that only New York law would govern. Judge Illston

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also noted that California has a long history of adopting and tailoring legal standards to safeguard the free flow of information. Accordingly, she applied California law.

More on the Privity Question

Judge Illston also decided a motion to dismiss brought by Deutsche Bank Securities, Inc. (DBSI), the underwriter of the ARS. In turns out that DBSI is also the defendant in *Louisiana Pacific Corp. v. Money Mkt. 1 Institutional Inv. Dealer*, Fed. Sec. L. Rep. (CCH) P96,262 (March 28, 2011), which I wrote about in this post on Tuesday. According to the court's opinion, TAC also brought claims under Corporations Code Sections 25500 and 25501. However, when Judge Illston analyzed TAC's claims, she referred only to Section 25501 (which establishes the remedies for violations of Section 25401), agreed that privity is required, and said nothing about whether privity is required under Section 25500.

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