New York High Court Holds That State Blue Sky Law Does Not Preempt Common Law Claims Involving Securities

January 4, 2012 by John Stigi and Tyler Baker

In *Assured Guaranty (UK) Ltd. v. J. P. Morgan Investment Management Inc.*, 2011 N.Y. Slip Op. 09162, 2011 WL 6338898 (N.Y. Dec. 20, 2011), the New York Court of Appeals held that the Martin Act, N.Y. Gen. Bus. Law art. 23-A — New York's "blue sky" law designed to address fraudulent practices in the marketing of securities — does not preempt common law causes of action for breach of fiduciary duty and gross negligence in connection with the marketing or sale of securities, even if the alleged wrongdoing also would fall within the purview of the Martin Act. This decision thus eliminates a defense to New York common law causes of action relating to securities.

Plaintiff Assured Guaranty (UK) Ltd. ("Assured Guaranty") brought claims for breach of fiduciary duty, gross negligence and breach of contract against Defendant J. P. Morgan Investment Management Inc. ("J.P. Morgan") due to J.P. Morgan's alleged mismanagement of nonparty Orkney Re II PLC's ("Orkney") investment portfolio, the obligations of which plaintiff guaranteed. Assured Guaranty asserted that J.P. Morgan failed to diversify the portfolio or advise Orkney of the true level of risk involved, and that J.P. Morgan improperly made investment decisions in favor of nonparty Scottish Re Group Ltd., a client of J.P. Morgan and Orkney's largest equity holder, rather than for the benefit of Orkney or Assured Guaranty. Assured Guaranty alleged that Orkney suffered substantial financial losses, triggering Assured Guaranty's obligation to pay under its guarantee.

J.P. Morgan moved to dismiss the complaint, arguing (among other things) that the breach of fiduciary and gross negligence claims were preempted by New York's Martin Act. The Martin Act 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. J.P. Morgan contended that because the statute vests the Attorney General with exclusive authority over fraudulent securities and investment practices addressed by the statute, it would be inconsistent to allow private investors to bring overlapping common law claims.

The Supreme Court, New York County (Kapnick, J.), granted J.P. Morgan's motion to dismiss. It agreed that the breach of fiduciary duty and gross negligence claims fell within the purview of the Martin Act and their prosecution by Assured Guaranty would be inconsistent with the Attorney General's exclusive enforcement powers under the Act. *Assured Guar. (UK) Ltd. v J.P. Morgan Inv. Mgt., Inc.*, 28 Misc. 3d 1215(A), 2010 WL 2977934 (Sup. Ct. N.Y. Co. Jan. 28, 2010). The Appellate Division, First Department reversed, reinstating the breach of fiduciary duty and gross negligence causes of action and part of the contract claim. The court concluded that nothing in the plain language of the Act, its legislative history or appellate level decisions supported preemption of the common law causes of action. The Appellate Division nevertheless granted J.P. Morgan leave to appeal on a certified question to the Court of Appeals. *Assured Guar. (UK) Ltd. v J.P. Morgan Inv. Mgt. Inc.*, 80 A.D.3d 293, 915 N.Y.S.2d 7 (1st Dep't 2010), *lv. granted*, N.Y. Slip Op. 64361[u] (1st Dep't 2011).

The Court of Appeals affirmed the decision of the Appellate Division. In deciding whether the Martin Act was intended to supplant the non-fraud common law claims, the Court of Appeals looked to the plain text of the statute as well as the legislative intent behind the Act, reviewing the purpose of each of a number of the Act's amendments throughout the 20th century. The Court held that the plain text of the Martin Act, while granting the Attorney General investigatory and enforcement powers and prescribing various penalties, does not expressly mention or otherwise contemplate the elimination of common law claims. The Court observed that the Act, as originally conceived in 1921, did not evince any intent to displace all common law claims in the securities field.

The Court went on to observe that although the Martin Act does not create a private right of action, and thus "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," there was nothing in the legislative history of the various amendments that demonstrated a "clear and specific" legislative mandate to abolish preexisting common-law claims that private parties would otherwise possess. In other words, an injured investor may bring a common law claim (for breach of fiduciary duty, gross negligence, fraud or otherwise) that is not entirely dependent upon the Martin Act for its viability because the "[m]ere overlap between the common law and the Martin Act is not enough to extinguish common-law remedies."

The Court also held that policy concerns militated in favor of allowing Assured Guaranty's common law claims to proceed. Looking to the purpose of the statute — combating fraud and deception in securities transactions — the Court concluded that the Martin Act is not impaired by private common law actions that have a legal basis independent of the statute because proceedings by the Attorney General and private actions further the same goal of combating fraud and deception in securities transactions. The Court reasoned that a ruling which held that the Martin Act precluded common law actions would leave the marketplace “less protected than it was before the Martin Act’s passage, which can hardly have been the goal of its drafters.”

As stated above, the Court of Appeals’ decision eliminates a legal defense to New York common law actions arising from alleged wrongdoing in connection with the marketing or sale of securities.

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