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# Litigation

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## NEW YORK COURT OF APPEALS HOLDS THAT THE MARTIN ACT DOES NOT PREEMPT SIMILAR COMMON-LAW CLAIMS

In a unanimous decision rendered earlier this week, New York's highest court ruled that the Martin Act—New York's "blue sky" law—does not preempt common-law claims for breach of fiduciary duty or gross negligence, even if the alleged wrongdoing would also fall within the Martin Act's purview. *See Assured Guaranty (UK) Ltd., v. J.P. Morgan Investment Management Inc.*, 2011 WL 6338898 (N.Y. Dec. 20, 2011). In so concluding, the court has largely foreclosed a defense regularly raised by defendants in securities-related cases, and the decision may change the landscape of securities litigation brought under New York law.

### Background

Assured Guaranty (UK) Ltd. ("Assured Guaranty") brought this action against J.P. Morgan Investment Management Inc. ("J.P. Morgan"), alleging that J.P. Morgan mismanaged the portfolio of a third-party company, Orkney Re II PLC ("Orkney"). Assured Guaranty was the party allegedly injured by the mismanagement because it guaranteed Orkney's financial obligations. As a result, Assured Guaranty brought suit against J.P. Morgan, asserting claims for breach of fiduciary duty, gross negligence, and breach of contract.

J.P. Morgan moved to dismiss the case, in relevant part, on the ground that the breach of fiduciary duty and gross negligence claims were preempted by the Martin Act. The trial court granted J.P. Morgan's motion, and Assured Guaranty appealed. The Appellate Division reinstated Assured Guaranty's claims. *Assured Guaranty (UK) Ltd. v. J.P. Morgan Investment Management Inc.*, 915 N.Y.S.2d. 7 (1st Dep't 2010). The court held that nothing in the statutory language of the Martin Act, the legislative history, or the appellate level decisions in New York indicate that the Act was intended to preempt valid common-law causes of action. This appeal followed.

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## The New York Highest Court's Holding

As the Court of Appeals noted, the Martin Act authorizes New York's Attorney General to "investigate and enjoin fraudulent practices in the marketing of stocks, bonds and other securities within or from New York." Unlike a private plaintiff alleging fraud, the Attorney General is not required to "allege or prove either scienter or intentional fraud" in any civil action commenced under the Martin Act. In at least two prior opinions, the New York Court of Appeals concluded that the Martin Act did not create a private right of action. Taken together, this led a number of state and federal courts in New York to conclude that the Martin Act preempted claims that did not require proof of an element beyond those required to impose liability under the Martin Act, such as claims for negligent misrepresentation or breach of fiduciary duty.

In *Assured Guaranty*, the Court of Appeals reaffirmed that 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." In contrast, the Martin Act does not preempt common-law claims that "an injured investor may bring . . . that [are] not entirely dependent on the Martin Act for [their] viability." According to the court, "[m]ere overlap between the common law and the Martin Act is not enough to extinguish common-law remedies."

The court also addressed J.P. Morgan's policy-based argument that the Martin Act preempts common-law claims to preserve the New York Attorney General's exclusive enforcement authority. The court disagreed with J.P. Morgan, and instead agreed with the arguments put forth by, among others, the New York Attorney General, that private common-law actions with an independent legal basis do not impair the Martin Act. Instead, such actions "further the same goal—combating fraud and deception in securities transactions."

## Conclusion

This decision settles an issue that had divided state and federal courts in New York. While it is too early to predict the full ramifications of this decision, it will almost certainly make it more difficult for defendants to succeed on motions to dismiss these types of claims, as plaintiffs can now proceed on theories that do not require an allegation or proof of scienter.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any member of our Litigation and Arbitration Group listed below.

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