



NY STATE ATTORNEY GENERAL'S AGGRESSIVE USE OF MARTIN ACT REVIVES FEDERAL PREEMPTION OBJECTION

by Robert A. McTamane

The recently announced investigation by New York Attorney General Eric Schneiderman into Exxon Mobil Corporation's disclosures regarding climate change¹ again raises the question what limits, if any, exist on his office's powers under New York's Martin Act.² This most curious statute, passed in 1921 to control bucket shops and boiler rooms, has long been the scourge of the United States securities industry. One of America's most successful industrial businesses has now been swept up in the law's vortex.

The Exxon Mobil investigation seems directed at the company's many statements over many years about climate change. General Schneiderman is presumably searching for some misstatement of a material fact that somehow eluded the Securities and Exchange Commission's reviews. The announcement of the attorney general's subpoena came just days after the partial settlement of a Martin Act investigation, now eight years old, of Peabody Energy and others, requiring additional disclosures about the adverse effects of climate change.³ The investigation alleged that Peabody had routinely disclosed the increased effects of additional government regulation, rather than effects of climate change itself.

Under federal securities law, opinions expressed by regulated issuers must be both objectively false and also subjectively not believed for the SEC or other regulators to take corrective action.⁴ Contrast this properly formidable hurdle with the incredible ease of proof of Martin Act "fraud," where scienter—or intent to defraud—is never required. The statement need only be, in the attorney general's sole discretion, false and material, in order for him to initiate and pursue a Martin Act case, where complete honesty and entire good faith by the persons making the statement are entirely irrelevant. Procedurally, the Martin Act gives the attorney general enormous power, unparalleled in any other US prosecutorial context. Martin Act subpoena power is virtually limitless, without any prior judicial oversight. Witnesses have no right to counsel or privilege against self-incrimination, and without a requirement that the government prove scienter, reliance, or even damages, most Martin Act cases quickly settle, often at high cost.

Federal Preemption. The U.S. Constitution's Supremacy Clause nullifies any state law that conflicts with federal law. The federal laws regulating the securities markets, and their relationship to laws such as the Martin Act, are an example of implied preemption, and, more specifically, "field" preemption. Field preemption occurs when federal laws "occupy the field" of government oversight, leaving no room for state regulation.⁵

¹ Chris Mooney, *New York is Investigating Exxon Mobil for Allegedly Misleading the Public About Climate Change*, WASH. POST, Nov. 15, 2015, available at <https://www.washingtonpost.com/news/energy-environment/wp/2015/11/05/exxonmobil-under-investigation-for-misleading-the-public-about-climate-change/>.

² NEW YORK GENERAL BUSINESS LAW, Art. 23-A, §§ 352-353.

³ Clifford Krauss, *Peabody Energy Agrees to Greater Disclosures of Financial Risks*, NY TIMES, Nov. 8, 2015.

⁴ See *Virginia Bankshares v. Sandberg*, 501 U.S. 1083 (1991), and *Omnicare v. Laborers District Council*, 135 S. Ct. 1318 (2015).

⁵ See Frank Cruz-Alvarez, et al., *Federal Preemption: Origins, Types and Trends in the U.S. Supreme Court*, WLF MONOGRAPH, Oct. 2015, available at <http://www.wlf.org/upload/legalstudies/monograph/10-2015CruzAlvarezMonograph.pdf>.

The bedrock federal securities laws, including the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940, arguably accomplished such preemption years ago. Congress's more recent securities enactments further populated the field. These laws include the Private Securities Litigation Reform Act (private securities litigation standards); the Securities Litigation Uniform Standards Act (precluding state securities actions); and the National Securities Markets Improvement Act (NSMIA) (expressly preempting all state blue sky laws and specifically designating the federal government as the *exclusive* regulator).

The cumulative effect of federal law is simply overwhelming. For example, the NSMIA does not save any authority for the states regarding disclosure or lack of it applicable to climate change or any other contentious issue. NSMIA's savings clause only preserves for state securities commissions or similar agencies the authority "to investigate and bring enforcement actions *with respect to fraud or deceit*, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions."⁶

The critical issue, then, is what "fraud and deceit" is left open to the states to regulate? While the legislative history of the NSMIA has a statement of intent "not to alter, limit, expand, or otherwise affect in any way any State statutory or common law with respect to fraud or deceit ... in connection with securities or securities transactions,"⁷ the only meaning that gives credible effect to Congress's intent to preempt the field is that Congress meant "fraud" as it is so well and commonly understood at the federal level.

A finding of fraud as referenced in the NSMIA thus would require a knowing violation, reasonable reliance, and a demonstrated causal connection between the fraud and the harm in some particular transaction. Any lesser concept of "fraud," such as the virtually strict-liability meaning of the term under the Martin Act, would allow the states to define for themselves the breadth of the federal NSMIA savings clause, a result that Congress cannot have intended.

An Opponent Willing to Fight? When former New York Attorney General Eliot Spitzer reawakened the Martin Act, a WLF LEGAL BACKGROUNDER argued that a panoply of federal statutes preempt the New York law.⁸ Since then, other commentators,⁹ including one dissenting New York judge, have shared that conclusion. How has the Martin Act continued as such a force if it has been so obviously preempted decades ago? In the years leading up to Spitzer's reanimation of the law, the attorney general utilized it most often in cases involving worm farms and modest Ponzi schemes.¹⁰ Such enforcement targets were not the type to mount sophisticated legal defenses against their prosecutions. Post-Spitzer, the law has become such a one-sided vehicle of corporate destruction that most defendants have preferred to settle.

The federal preemption question arose most squarely in the seemingly endless prosecution of Maurice Greenberg, former Chairman and CEO of AIG. The state's highest court, the Court of Appeals, was poised to consider the issue in early 2013. But then-Attorney General Andrew Cuomo dropped the damages claims at the eleventh hour, avoiding a decision by the court on the preemption issue.

The Martin Act will inevitably have its day in court, perhaps before the U.S. Supreme Court. In Exxon Mobil, the attorney general may have finally encountered a defendant with the wisdom and will to oppose this law and end the procedural and substantive abuses it has embodied.

⁶ H.R. Rep. 104-622, 104th Cong., 2nd Sess. 1996 at *34 (emphasis added).

⁷ *Ibid.*

⁸ Robert A. McTamoney, *New York's Martin Act, Expanding Enforcement in an Era of Federal Securities Regulation*, WLF LEGAL BACKGROUNDER, Feb. 28, 2003, available at <http://www.wlf.org/upload/022803LBMctamoney.pdf>.

⁹ *E.g.*, Jonathan R. Macey, *Positive Political Theory and Federal Usurpation of the Regulation of Corporate Governance: The Coming Preemption of the Martin Act*, 80 NOTRE DAME L. REV. 951 (2005); *People v. Greenberg*, 95 A.D.3d 474 (First Dep't 2012) (Catterson, J., dissenting).

¹⁰ Nicholas Thompson, *The Sword of Spitzer*, LEGAL AFFAIRS, May/June 2004, available at http://www.legalaffairs.org/issues/May-June-2004/feature_thompson_mayjun04.msp.