



NY HIGH COURT IGNORES PREEMPTION DEFENSE TO MARTIN ACT, BUT US SUPREME COURT OFFERS POSSIBLE PATH FORWARD

by Robert A. McTamane

Over the past year, New York's infamous Martin Act¹ has experienced a revival of national relevance reminiscent of 2001, when Attorney General Eliot Spitzer began using the 1921 law in his post-Enron crusade against Wall Street. New York's current attorney general, Eric Schneiderman, recently invoked the Martin Act's broad civil subpoena power to probe Exxon Mobil's disclosures regarding climate change.² In addition, a June 2016 decision by New York's highest court in the long-running *People v. Greenberg* litigation endorsed the attorney general's aggressive interpretation of the law. This LEGAL OPINION LETTER discusses that litigation and the New York Court of Appeals' brusque and unsupported rejection of the defendants' federal preemption argument.

In 2005, Attorney General Spitzer brought suit against insurance giant AIG, AIG's Chairman Maurice "Hank" Greenberg, and Chief Financial Officer Howard Smith. Faced with the extraordinary breadth of the available claims and the corresponding ease of proof under the Martin Act, AIG quickly settled the suit with New York and a separate suit with the federal Securities and Exchange Commission (SEC).

After the company settled, General Spitzer amended his complaint against the individual executives, dropping all charges except those under the Martin Act. Because the law does not require proof of intent or damages, this tactic relieved the state from having to prove Greenberg or Smith ever knowingly violated the law.

General Schneiderman is now the third New York attorney general to advance Spitzer's original Martin Act claims against the former AIG executives. The heart of the remaining case involves reinsurance that AIG had negotiated with General Re, which the state claims did not in fact transfer risk and which, therefore, should not have improved AIG's reserves. In addition, the state claims fraud in another deal AIG made with another insurer intended to convert ordinary losses to capital losses. No false revenues were ever created, and no false profits were ever booked. The case is now over a decade old.

Separate from the Martin Act suit, Greenberg and Smith settled actions brought by the SEC and by AIG shareholders. In order to avoid the *res judicata* effect of the private litigation settlement on the state's pursuit of restitution, the attorney general framed his damages claim as one seeking disgorgement of purportedly undeserved bonuses. The suit now further requests a nationwide injunction against Greenberg and Smith barring them from participation in the securities industry and prohibiting them from ever serving again as officers or directors in a public company.

¹ New York General Business Law, Art. 23-A, §§ 352-353.

² See Robert A. McTamane, *NY State Attorney General's Aggressive Use of Martin Act Revives Federal Preemption Objection*, WLF LEGAL OP. LTR., Feb. 12, 2016, available at http://www.wlf.org/upload/legalstudies/legalopinionletter/021216LOL_McTamane.pdf; Prof. Philip Hamburger, *Civil Subpoenas Unilaterally Issued by State Attorneys-General Are Constitutionally Suspect*, WLF LEGAL OP. LTR., Feb. 12, 2016, available at http://www.wlf.org/upload/legalstudies/legalopinionletter/021216LOL_Hamburger.pdf.

On appeal from a loss in the trial court, the defendants argued that the Martin Act does not grant New York the authority to seek disgorgement or to impose nationwide injunctions. They also argued that the state claims conflicted with federal securities regulation and should thus be preempted under the US Constitution's Supremacy Clause. A panel of the New York Supreme Court, Appellate Division, upheld the state's authority to pursue disgorgement and injunctive relief under the Martin Act. *People v. Greenberg*, 127 A.D.3d 529 (1st Dep't 2015).

In a terse opinion, the New York Court of Appeals affirmed the Appellate Division's decision on June 2, 2016. *People v. Greenberg*, 2016 NY Slip Op. 04253. The court gave especially short shrift to the preemption defense, basically ignoring it other than stating in a half sentence, "Nor is there any merit to defendants' arguments that such relief is barred under the Supremacy Clause." Such an offhanded rejection befits neither the level of reasoning one expects from a state's highest court nor the gravity of the preemption argument's implications for basic principles of federalism.

Lower courts have been less dismissive. In a 2012 Supreme Court, Appellate Division, ruling in the Greenberg and Smith action, Judge Catterson dissented from the majority's reasoned conclusion on preemption. *People v. Greenberg*, 95 A.D.3d 474 (First Dep't 2012). Judge Catterson wrote, "Congress has determined that efficient securities markets require a uniform national standard governing liability for private class actions." *Id.* at 490. New York's pursuit of "a lawsuit for the benefit of private parties" (*i.e.*, AIG shareholders), *ibid*, conflicted with several federal laws that establish uniform securities class-action rules, including the Private Securities Litigation Reform Act of 1995 (PSLRA) and the Securities Litigation Uniform Standards Act of 1998 (SLUSA). Judge Catterson emphasized that the Martin Act's strict-liability regime for establishing a violation directly conflicted with the 1995 and 1998 laws, which require proof of scienter and reliance. *Id.* at 491. Before the Court of Appeals had the opportunity to weigh in on preemption, then-Attorney General Andrew Cuomo dropped the damages claim, rendering appeal of the 2012 Appellate Division opinion moot.

New York's high court missed another opportunity to fully address the preemption argument in 2016. The state essentially admitted that its pursuit of disgorgement was a thinly veiled damages claim. The rationale Judge Catterson offered in 2012 as to why PSLRA and SLUSA preempted the Martin Act damages claims thus applies equally to disgorgement. The state's injunction requests also conflicted directly with the federal government's regulation of securities. The SEC investigated the actions of Greenberg and Smith, and it entered an agreement with the defendants under which Smith served a three-year ban on holding director or officer positions. The Commission declined to impose the lifetime, nationwide ban New York is seeking on either defendant. The New York Court of Appeals, by allowing the state to second-guess the SEC, directly undermined the uniformity Congress sought when crafting federal securities laws.

The latest *Greenberg* opinion makes it that much more unlikely that Martin Act federal preemption arguments will receive fair consideration in New York courts. Enforcement targets, however, might consider an intriguing alternative approach arising out of a recent US Supreme Court case. In *Gobeille v Liberty Mutual Insurance Co.*, 136 S. Ct. 936 (2016), the Court held that the federal Employee Retirement Income Security Act (ERISA) preempted Vermont's statute and regulation requiring that all health insurers file health care payments reports with the state. Most relevant for Martin Act targets, after receiving a subpoena from Vermont, the Respondent immediately sought a judicial declaration that ERISA preempts the state reporting mandate. In responding to Vermont's argument that Liberty Mutual could not seek declaratory relief, Justice Kennedy responded, "A plan need not wait to bring a pre-emption claim until confronted with numerous inconsistent obligations and encumbered with any ensuing costs." *Id.* at 945.

Justice Kennedy's rationale applies equally to any individual or entity accused of running afoul of the Martin Act. The law's enforcement targets face an extremely burdensome discovery process as well as the public-shaming campaign that now routinely accompanies Martin Act cases. Thus, Martin Act defendants would be wise to consider seeking a federal judicial declaration at the outset of litigation that federal securities laws and regulations preempt the Act.