New York's Highest Court Holds That Three-Year Statute of Limitations Applies to Martin Act Claims

July 2, 2018

On June 12, 2018, the New York Court of Appeals overruled longstanding Appellate Division precedent and held that fraud claims brought by the New York Attorney General ("NYAG") under the Martin Act (General Business Law article 23-A, § 352**, *et seq*.) are governed by a three-year statute of limitations, and not the six-year statute applicable to actions "based upon fraud," because the Martin Act expands liability for "fraudulent practices" beyond that recognized under the common law.[1] The court remitted to the trial court whether the three- or six-year limitations period would apply to related claims brought by the NYAG under Executive Law § 63(12). While the NYAG has sought to minimize the significance of the Court's decision, the shortened limitations period may have a substantial impact on its ability to conduct investigations and bring Martin Act claims.**

HISTORY

New York's General Business Law article 23-A, § 352, *et seq.*, commonly known as the Martin Act, permits the NYAG to bring civil and criminal suits alleging "fraud" and "fraudulent" practices in connection with the offer, sale, or purchase of securities. The Martin Act eliminates many of the pleading and evidentiary requirements of an ordinary legal action for fraud, allowing the NYAG to bring claims based only upon proof of a material misrepresentation of fact in the sale or promotion of a security within or from New York. This does away with various other elements of state common-law fraud, including scienter (*i.e.*, proof that the defendant intended others to rely on the misrepresentation), reasonable reliance (*i.e.*, proof that anyone did justifiably rely on the misrepresentation), and damages (*i.e.*, proof that the misrepresentation caused anyone cognizable harm).[2]

The NYAG often brings Martin Act claims alongside related claims under New York Executive Law § 63(12), which authorizes the NYAG to bring an action against any person who has "engage[d] in repeated fraudulent or illegal acts or otherwise demonstrate[d] persistent fraud or illegality" in order to "enjoin the continuance . . . of any such business activity or of any fraudulent or illegal acts, [and] direct[ ] restitution and damages" for such conduct.

In recent years, the NYAG has invoked these dual statutory grants of authority to conduct far-reaching investigations of, and to secure settlements from, public companies and financial institutions, including in a number of high-profile cases.

CASE BACKGROUND

After an investigation, the NYAG commenced an action in November 2012 against defendants Credit Suisse Securities (USA) LLC and affiliated entities (together, "Credit Suisse") alleging various fraudulent

[1] *Schneiderman v. Credit Suisse Sec. (USA) LLC*, 2018 WL 2899299, at *1 (N.Y. June 12, 2018).
[2] *Eurycleia Partners, LP v. Seward & Kissel, LLP*, 12 N.Y.3d 553, 559 (2009).

acts in connection with the issuance of residential mortgage-backed securities in 2006 and 2007. The NYAG asserted two causes of action: the first for fraudulent acts in violation of the Martin Act; the second for repeated fraudulent or illegal acts (including, *inter alia*, violations of the Martin Act) in violation of Executive Law § 63(12).

The New York Supreme Court denied a motion to dismiss by Credit Suisse, which unsuccessfully argued that the NYAG's action was time-barred under the three-year statute of limitations established by CPLR 214(2). The Supreme Court found that the essence of the NYAG's claims under both Executive Law § 63(12) and the Martin Act mirrored the longstanding common-law tort of investor fraud, premised on a false representation in order to induce investors to purchase their securities.[3] As such, the Supreme Court found that the NYAG was not seeking to recover upon a "liability . . . created or imposed by statute," as would be required under CPLR 214(2).

The Appellate Division affirmed in a 3-2 decision, following prior holdings to apply a six-year statute of limitations to Martin Act claims.[4] The Appellate Division noted that the language in Executive Law § 63(12) parallels that of the Martin Act, reading both as targeting "wrongs that existed before the statute's enactment, as opposed to targeting wrongs that were not legally cognizable before enactment."[5] The two dissenting opinions took the position that the three-year statute of limitations under CPLR 214(2) should apply based on the lack of a scienter requirement and the statutes' coverage of a wider range of deceptive business practices than had been condemned at common law.[6]

COURT OF APPEALS' DECISION

The Court of Appeals modified the order of the Appellate Division and ordered the dismissal of the Martin Act claim as time-barred, holding that the three-year statute of limitations under CPLR 214(2) governs because the Martin Act imposes numerous "liabilities" that did not exist at common law.[7] The Court of Appeals remitted to the Supreme Court the question of whether to apply a three- or six-year statute of limitations to the NYAG's Executive Law § 63(12) claim based on further analysis of the underlying allegations.

With respect to the NYAG's Martin Act claim, the Court of Appeals framed the principal question as being whether Martin Act claims are "action[s] to recover upon a liability, penalty or forfeiture created or imposed by statute." If so, the claim would be governed by the three-year statute of limitations set out in CPLR 214(2). If not, a six-year statute of limitations would apply based on either CPLR 213(8) (governing "action[s] based upon [actual] fraud") or CPLR 213(1) (a "residuary provision applicable to an action for which no limitation is specifically prescribed by law").[8] To answer this question, the Court invoked the "well-settled" test described in *Gaidon v. Guardian Life Ins. Co. of Am*., which explained that CPLR 214(2) only applies "where liability 'would not exist but for a statute.'"[9] Thus, CPLR 214(2)'s three-year statute does not apply where a statute codifies or implements an existing common-law liability, and only applies when a statute creates liabilities that did not exist at common law.

After reviewing the statutory scheme and relevant legislative history, the Court concluded that the Martin Act had not merely codified or recognized existing liabilities, but instead went beyond the existing framework to create new liabilities for "fraudulent practices" that had not been cognizable at common law. The Court reasoned that the Martin Act's references to "fraudulent practices"—as repeatedly amended by

[3] 46 Misc. 3d 1211A (N.Y. Sup. Ct. 2014).
[4] *State of New York v. Bronxville Glen I Assocs.*, 181 A.D.2d 516 (1st Dep't 1992).
[5] 145 A.D. 3d 533, 535 (1st Dep't 2016).
[6] *Id.* at 539 (Andrias, J., dissenting).
[7] *Credit Suisse Sec.*, 2018 WL 2899299, at *7.
[8] *Id.* at *4-*5 (internal quotations omitted).
[9] 96 N.Y.2d 201, 208 (2001) (*quoting Aetna Life & Cas. Co. v. Nelson*, 67 N.Y.2d 169, 174 (1986)).

the legislature and interpreted by the courts—encompassed "wrongs" beyond those that could be pursued at common law, pointing in particular to decisions that allowed Martin Act claims to proceed without proof of scienter or justifiable reliance, and noting the absence of any accompanying private right of action for such claims.[10] The Court also cited as consistent its treatment of allegations of "deceptive practices" under General Business Law § 349(h), to which the Court had applied a three-year statute of limitations under CPLR 214(2) based on differences between the covered conduct and the common law.[11]

With respect to the NYAG's Executive Law § 63(12) claim, the Court first noted that, to the extent Executive Law § 63(12) provides a stand-alone cause of action, such a claim would be governed by the same three-year statute of limitations as the Martin Act.[12] Unlike the Martin Act, however, the Executive Law authorizes the NYAG "to pursue fraud claims under other statutes or common law theories on a 'look through' basis."[13] Where the NYAG uses Executive Law § 63(12) "to redress liabilities recognized elsewhere in the law," the Court ruled that judges must look "'look through' Executive Law § 63(12) and apply the statute of limitations applicable to the underlying liability."[14] If the conduct underlying the claim amounts to a type of fraud recognized at common law, the action will be governed by a six-year statute of limitations.[15] Because this question had not been fully briefed or considered by the lower courts, the issue was placed on remittal.

IMPLICATIONS

The narrowing of the Martin Act statute of limitations to three years may have a significant impact on the NYAG's ability to conduct investigations and bring Martin Act charges against public companies and financial institutions. While the NYAG's office has publicly sought to minimize the perceived significance of the decision,[16] one could expect to see accelerated investigations, increased requests for tolling agreements, or possible abandonment of Martin Act charges in favor of common-law-based charges with a longer, six-year statute of limitations where possible. The Martin Act, however, historically has been one of the NYAG's strongest weapons to investigate and pursue alleged financial fraud, and resort to common-law-based fraud theories, with the attendant higher burden of proof, would likely make pursuing such cases significantly more onerous. Finally, it is also possible that the NYAG may call for a legislative solution to extend its Martin Act authority, particularly if it perceives a loss of investigative advantage based on the five-year statute of limitations enjoyed by federal authorities pursuing claims for securities fraud under federal law.

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[10] *Credit Suisse Sec.*, 2018 WL 2899299, at *9.

[11] *Id.* at *2 (*citing Gaidon v. Guardian Life Ins. Co. of Am.*, 96 NY2d 201, 208 (2001)).

[12] *Id.*

[13] *Id.* at *3.

[14] *Id.*

[15] *Id.*

[16] *See* Christie Smythe, *Credit Suisse Wins Narrowing of $11 Billion Suit, Martin Act,* BLOOMBERG (June 12, 2018) (statement of Amy Spitalnick, spokesperson for Attorney General Barbara Underwood) ("This decision will have no impact on our efforts to vigorously pursue financial fraud wherever it exists in New York . . . . That includes continuing our case against Credit Suisse").

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