SULLIVAN & CROMWELL LLP

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Schneiderman v. *Credit Suisse Securities (USA) LLC*: New York Court of Appeals Holds That Martin Act Claims Are Governed by Three-Year Statute of Limitations

Decision Overrules 26-Year-Old Appellate Division Precedent That Applied Six-Year Statute of Limitations to Martin Act Claims Brought by New York Attorney General

SUMMARY

On June 12, 2018, the New York Court of Appeals—the State's highest court—held that claims by the New York Attorney General ("NYAG") for "fraud" under New York's General Business Law article 23-A, commonly known as the Martin Act, are subject to a three-year statute of limitations for statutory claims, because the Martin Act imposes liabilities that "did not exist at common law."[1]

The Court left unresolved whether claims by the NYAG under New York's Executive Law § 63(12) are subject to a three- or six-year statute of limitations. Instead, the Court remitted that decision to the trial court to determine whether "the conduct underlying" the NYAG's Executive Law § 63(12) claim amounts to (i) "a type of fraud recognized in the common law," in which case the claim would be subject to a six-year statute of limitations, or (ii) a type of fraud not recognized in the common law, in which case the three-year statute of limitations would apply.[2]

Because of the NYAG's repeated reliance on the Martin Act in recent years in bringing cases seeking large penalties, particularly against financial institutions in cases arising out of the financial crisis, the Court of Appeals' decision is significant and provides defendants with an important defense against claims involving stale conduct. This potential defense, in turn, may cause the NYAG to accelerate the pace of investigations and lawsuits.

BACKGROUND

The Martin Act is "the primary weapon afforded to" the NYAG "to combat securities fraud."[3] The Martin Act gives the NYAG "broad regulatory and remedial powers to prevent fraudulent securities practices."[4] Unlike the requirements for a plaintiff proving fraud under New York common law, the NYAG need not prove scienter or reliance in a civil action under the Martin Act; instead the NYAG must prove only: (1) a false or misleading statement or omission; (2) that was material; and (3) was made in connection with "issuance, distribution, exchange, sale, negotiation or purchase [of securities] within or from" New York State.[5]

The NYAG often brings Martin Act claims in tandem with claims under New York Executive Law § 63(12), which authorizes the NYAG to bring an action to "enjoin[] the continuance . . . of any fraudulent or illegal acts, [and] direct[] restitution and damages" if the defendant has "engage[d] in repeated fraudulent or illegal acts."[6] In recent years, the NYAG has brought or threatened Martin Act claims against numerous financial institutions, using the absence of scienter and reliance requirements to secure large settlements.

On November 20, 2012, the NYAG filed suit against Credit Suisse under the Martin Act and Executive Law § 63(12), alleging that Credit Suisse "committed multiple fraudulent and deceptive acts in connection with the creation and sale of residential mortgage-backed securities ('RMBS')" in 2006 and 2007.[7]

Credit Suisse moved to dismiss the NYAG's claims as time-barred under CPLR 214(2), which imposes a three-year statute of limitations on actions "to recover upon a liability, penalty or forfeiture created or imposed by statute."[8] The Supreme Court, New York County denied the motion, citing precedent from the Appellate Division of the Supreme Court of New York, First Department that "'[l]iability is considered to be created by statute . . . if the statute establishes a unique species of liability entirely unknown at common law.'"[9] Because the NYAG sought "to impose liability on defendants based on the classic, longstanding common-law tort of investor fraud," the Supreme Court held that New York's six-year statute of limitations for fraud claims applied to the action.[10]

In a 3-2 decision, the First Department affirmed, reasoning that the six-year statute of limitations applied because the Martin Act and Executive Law § 63(12) "target wrongs that existed before the statutes' enactment, as opposed to targeting wrongs that were not legally cognizable before enactment."[11] Justices Andrias and Friedman dissented, arguing that because the Martin Act and Executive Law § 63(12) do not require proof of scienter or reliance, the NYAG's claims "would not exist at common-law because" they make "'actionable conduct that does not necessarily rise to the level of fraud.'"[12]

THE COURT OF APPEALS' DECISION

The Court of Appeals noted that "although the Martin Act is nearly a century old," the Court had "never had occasion to consider" the Martin Act's statute of limitations.[13] In a 4-1 decision, the Court of Appeals

held that the NYAG's Martin Act claim was subject to a three-year statute of limitations rather than a six-year statute of limitations.[14] With respect to the claim under Executive Law § 63(12), the Court of Appeals remitted to the Supreme Court for further proceedings.[15]

The Court of Appeals' Martin Act analysis was straightforward. The court looked to the long history of New York cases interpreting the Martin Act's reference to "fraudulent practices" as encompassing "'wrongs' not cognizable under the common law."[16] Because the NYAG need prove only a material misstatement to establish a Martin Act claim, and not scienter or justifiable reliance by investors, the court held that "the Martin Act imposes numerous obligations—or 'liabilities'—that did not exist at common law."[17] As a result, the NYAG's Martin Act claim sought "to recover upon a liability, penalty or forfeiture created by statute," and thus was time-barred by the three-year statute of limitations under CPLR 214(2).[18]

The Court of Appeals' analysis of the NYAG's Executive Law § 63(12) claim was more involved. According to the Court of Appeals, "[t]he parties dispute[d] whether Executive Law § 63(12) provides a standalone cause of action [similar to the Martin Act], rather than merely authorizing the Attorney General to pursue fraud claims under other statutes or common law theories on a 'look through' basis."[19] The majority reasoned that such a standalone claim, if it existed, would be subject to a three-year statute of limitations.[20] Regardless of whether such standalone claims exist, "Executive Law § 63(12) gives the Attorney General standing to redress liabilities recognized elsewhere in the law."[21] In those instances, courts must "'look through' Executive Law § 63(12) and apply the statute of limitations applicable to the underlying liability."[22] As such, an Executive Law § 63(12) claim could be based on common law fraud, in which case the claim would have a six-year statute of limitations.

Accordingly, the Court of Appeals applied the three-year statute of limitations to the Martin Act claim and ordered its dismissal. As to the Executive Law § 63(12) claim, the Court of Appeals remanded to the supreme court with the direction "to examine whether the conduct underlying the Executive Law § 63(12) claim amounts to a type of fraud recognized in the common law and, if so, the action will be governed by a six-year statute of limitations."[23] But the Court of Appeals warned that if the Supreme Court determines that the NYAG's complaint pleads the elements of "a type of fraud recognized in the common law" (and so is subject to the six-year statute of limitations), the NYAG "will be obliged to demonstrate each such element at the proof stage or the claim will be subject to dismissal as time-barred."[24]

Judge Feinman joined in the majority opinion but issued a separate concurrence, which he described as "entirely consistent with the majority's holding."[25] In his concurrence (joined by Judge Fahey), Judge Feinman stated that the common law recognizes "equitable fraud," which in his view requires only a material misrepresentation and justifiable reliance, as well as "actual fraud," which requires proof of scienter.[26] Judge Feinman further stated that the NYAG could premise an Executive Law § 63(12) claim upon either type of fraud, and that the NYAG had adequately pleaded the elements of equitable fraud in

its complaint against Credit Suisse. Judge Feinman also observed that the six-year statute of limitations provided by CPLR 213(1), which applies to "an action for which no limitation is specifically prescribed by law," would apply to an equitable fraud claim.[27] Thus, Judge Feinman reasoned that the Supreme Court should deny Credit Suisse's motion to dismiss the NYAG's Executive Law § 63(12) claim as untimely, unless Credit Suisse could show that reliance on the alleged misrepresentations was not justifiable.[28]

Judge Rivera dissented, arguing that the NYAG's claim under the Martin Act should be subject to a six-year statute of limitations because, looking to the "underlying nature of the claim itself," the NYAG had "adequately alleged scienter and reliance," and even assuming it did not, its claim "would still be based on fraudulent behavior recognized under decisional law when the Legislature enacted the Martin Act."[29]

IMPLICATIONS

The Court of Appeals left undecided the important question of the elements that the NYAG would have to prove to prevail on its Executive Law § 63(12) claim against Credit Suisse. At minimum, even if the Supreme Court were to follow the reasoning of Judge Feinman's concurrence, in which only one other judge joined, the NYAG would be required to prove justifiable reliance, which is more than would have been necessary for the NYAG to prove its Martin Act claim.

In the near term, the Court of Appeals' decision may prompt the NYAG to seek tolling agreements with entities that are subject to investigations of conduct that occurred near the three-year limit. In the longer term, the NYAG may be forced to accelerate investigations into potential Martin Act violations if it intends to use the Martin Act to bring claims without the burden of proving justifiable reliance and scienter.

Overall, the decision provides defendants with an important timeliness defense against Martin Act claims that previously appeared to be unavailable and may reduce the number of Martin Act claims that the NYAG is able to bring.

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ENDNOTES

[1] *Schneiderman* v. *Credit Suisse Sec. (USA) LLC*, 2018 WL 2899299, at *5 (N.Y. June 12, 2018).

[2] *Id.*

[3] *Assured Guar. (UK) Ltd.* v. *J.P. Morgan Inv. Mgmt. Inc.*, 18 N.Y.3d 341, 350 (2011).

[4] *CPC Int'l Inc.* v. *McKesson Corp.*, 70 N.Y.2d 268, 277 (1987).

[5] N.Y. Gen. Bus. Law § 352-c; *State* v. *Rachmani Corp.*, 71 N.Y.2d 718, 725 n.6 (1988).

[6] N.Y. Executive Law § 63(12).

[7] *Schneiderman* v. *Credit Suisse Sec. (USA) LLC*, 2018 WL 2899299, at *1 (N.Y. June 12, 2018). During the NYAG's investigation into Credit Suisse's RMBS business, the parties entered into a tolling agreement effective March 8, 2012, meaning that courts would treat March 8, 2012 as the commencement date of the action. *Id.* at *1 n.1. The NYAG's suit involved RMBS issued by Credit Suisse in 2006 and 2007. *Id.* at *1.

[8] N.Y. C.P.L.R. 214(2).

[9] *Schneiderman v. Credit Suisse Sec. (USA) LLC*, 2014 WL 7665038, at *3 (N.Y. Sup. 2014) (quoting *State* v. *Bronxville Glen I Assocs.*, 181 A.D.2d 516, 516 (1st Dep't 1992)).

[10] *Id.* at *6.

[11] *Schneiderman* v. *Credit Suisse Sec. (USA) LLC*, 145 A.D.3d 533, 535 (1st Dep't 2016).

[12] *Id.* at 539 (Andrias, J., dissenting) (quoting *Gaidon* v. *Guardian Life Ins. Co. of Am.*, 96 N.Y.2d 201, 209 (2001)).

[13] *Schneiderman* v. *Credit Suisse Sec. (USA) LLC*, 2018 WL 2899299, at *3 (N.Y. June 12, 2018).

[14] *Id.* at *1.

[15] *Id.*

[16] *Id.* at *5.

[17] *Id.*

[18] *Id.* at *1.

[19] *Id.* at *5.

[20] *Id.*

[21] *Id.*

[22] *Id.*

[23] *Id.*

[24] *Id.*

[25] *Id.* at *6 (Feinman, J., concurring).

[26] *Id.*

[27] *Id.* at *10.

[28] *Id.* at *12.

[29] *Id.* at *15 (Rivera, J., dissenting).

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