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GENERAL BUSINESS LAW

GBL § 352-c: No private cause of action under New York's "blue sky" law

Article 23-A of New York's General Business Law, commonly referred to as the Martin Act,¹ was enacted to protect the public against fraud in its relations with the business world by curbing deceptive or misleading conduct in the offer and sale of securities.² The Martin Act was amended in 1955 to add several new sections, including section 352-c,³ to "expressly broaden those acts and

¹ N.Y. GEN. BUS. LAW Art. 23-A, § 352, commentary at 5 (McKinney 1984). Securities laws stem back to thirteenth century England when a statute of Edward I authorized the licensing of brokers in the City of London. See L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 1 (1983). In the United States, several states had enacted "blue sky" laws by the turn of the present century, which aimed at curtailing speculative schemes with no more basis than "so many feet of 'blue sky.'" Hall v. Geiger-Jones Co., 242 U.S. 539, 550 (1917). Although there is mystery as to the origin of the term "blue sky law," it appears to have first achieved general use in Kansas "to describe legislation aimed at promoters who 'would sell building lots in the blue sky in fee simple.'" L. Loss, *supra*, at 8.

With the growth of industry and corporate business in the twentieth century, dishonest securities dealers increasingly engaged in fraudulent practices. See *id.* at 7. In New York, Governor Alfred Smith formed a commission to study the problem. This commission recommended the enactment of a statute providing for the forfeiture of the unrestricted right to sell securities should one engage in fraudulent practices. See Legis. Doc. No. 81, 143 Sess. (1920). As a result, the Martin Act, introduced by Assemblyman Martin in 1921, was enacted into law by a unanimous vote. N.Y. GEN. BUS. LAW Art. 23-A, § 352, commentary at 8 (McKinney 1984).

² N.Y. GEN. BUS. LAW Art. 23-A, § 352, commentary at 5-10 (McKinney 1984). Article 23-A is New York's "blue sky" law, governing "the offer and sale of securities, commodities and other species of investments in and from New York by conferring upon the Attorney General of New York some of the broadest and most easily triggered investigative and prosecutorial powers extant." *Id.* at 5. The purpose of the law is to prevent fraud, and thus the term fraud is given a wide meaning, including any act which tends to "deceive or mislead the purchasing public . . ." *People v. Federated Radio Corp.*, 244 N.Y. 33, 39, 154 N.E. 655, 657 (1926); see also *People v. Royal Sec. Corp.*, 5 Misc. 2d 907, 909, 165 N.Y.S.2d 945, 949-50 (Sup. Ct. Spec. T. N.Y. County 1955) (law applies even if fraudulent acts are not result of evil design or plan to defraud); *People v. Hooker*, 4 Misc. 2d 558, 559, 147 N.Y.S.2d 605, 606 (Sup. Ct. Spec. T. N.Y. County 1955) (purpose of act is to protect public from all varieties of fraud involving sale of securities).

Article 23-A is also liberally construed as a remedial statute "in order that its beneficent purpose may, so far as possible, be attained." *People v. Lexington Sixty-First Assoc.*, 38 N.Y.2d 588, 595, 345 N.E.2d 307, 311, 381 N.Y.S.2d 836, 840 (1976) (citation omitted); see also *State v. 820 Assoc.*, 116 Misc. 2d 901, 905, 456 N.Y.S.2d 604, 607 (Sup. Ct. Spec. T. N.Y. County 1982) (attorney general's powers under Martin Act are to be broadly construed); *Gardner v. Lefkowitz*, 97 Misc. 2d 806, 809, 412 N.Y.S.2d 740, 743 (Sup. Ct. Spec. T. N.Y. County 1978) (attorney general's power liberally construed to effectuate beneficent purpose of statute).

³ See N.Y. GEN. BUS. LAW § 352-c (McKinney 1984). Section 352-c provides in pertinent part:

practices coming within the condemnation of the statute," in order to combat "some of the modern abuses in the securities business."⁴ Section 352-c provides for the commencement of criminal proceedings against those who violate its provisions,⁵ but is silent as to

1. It shall be illegal and prohibited for any person, partnership, corporation, company, trust or association, or any agent or employee thereof, to use or employ any of the following acts or practices:

(a) Any fraud, deception, concealment, suppression, false pretense or fictitious or pretended purchase or sale;

(b) Any promise or representation as to the future which is beyond reasonable expectation or unwarranted by existing circumstances;

(c) Any representation or statement which is false, where the person who made such representation or statement: (i) knew the truth; or (ii) with reasonable effort could have known the truth; or (iii) made no reasonable effort to ascertain the truth; or (iv) did not have knowledge concerning the representation or statement made; where engaged in to induce or promote the issuance, distribution, exchange, sale, negotiation or purchase within or from this state of any securities or commodities . . .

2. It shall be illegal and prohibited for any person, partnership, corporation, company, trust or association, or any agent or employee thereof, to engage in any artifice, agreement, device or scheme to obtain money, profit or property by any of the means prohibited by this section.

Id.

⁴ Memorandum of Attorney General, L.1955, ch. 533, reprinted in [1955] N.Y. LEGIS. ANN. 133, 135 [hereinafter Memorandum]. See generally *People v. Essner*, 124 Misc. 2d 830, 833-34, 479 N.Y.S.2d 127, 130-31 (Sup. Ct. Crim. T. N.Y. County 1984) (purpose of Martin Act is to prohibit false representations regardless of whether sale or purchase resulted); *People v. Florentino*, 116 Misc. 2d 692, 693-99, 456 N.Y.S.2d 638, 640-44 (N.Y.C. Crim. Ct. N.Y. County 1982) (statute clearly prohibits fraud in sale or exchange of securities).

Several commentators have noted the great power granted to the attorney general under section 352-c. See L. LOSS, *supra* note 1, at 13-14; N.Y. GEN. BUS. LAW § 352, commentary at 8-9 (McKinney 1984). See generally *Essner*, 124 Misc. 2d at 833-34, 479 N.Y.S.2d at 130-31 (purposes of Martin Act are to prohibit false representations regardless of whether sale or purchase resulted and reliance is an element of charge in private civil action for damages under § 352-c); *Florentino*, 116 Misc. 2d at 693-99, 456 N.Y.S.2d at 642-45 (stating the clarity of the intent of § 352-c in prohibiting fraud in sale or exchange of securities).

⁵ See N.Y. GEN. BUS. LAW § 352(1)(McKinney 1984). Section 352 provides that the Attorney General may commence an investigation:

Whenever it shall appear . . . that in the advertisement, investment advice, purchase or sale [of any commodity or security] . . . any person, partnership, corporation, company, trust or association, or any agent or employee thereof, shall have employed . . . any device, scheme or artifice to defraud . . . [or engaged in] . . . deceptions, misrepresentations, concealments, suppressions, frauds, false pretenses, false promises, practices, transactions and courses of business . . . which is fraudulent or in violation of law . . .

Id. Prior to the 1955 amendment, section 352 enumerated acts deemed to be "fraudulent practices," but nothing in the Martin Act specifically declared such practices criminal or punishable. The fraudulent practices were merely a basis for investigation and possible injunction. N.Y. GEN. BUS. LAW § 352, commentary at 8 (McKinney 1984). See also *CPC Int'l, Inc. v. McKesson Corp.*, 120 App. Div. 2d 221, 234, 507 N.Y.S.2d 984, 992 (1st Dep't 1986) (prior to 1955 attorney general only authorized to seek injunction against fraudulent act).

whether a private litigant can commence and maintain a civil cause of action.⁶ Recently, in *CPC International, Inc. v. McKesson Corp.*,⁷ the Appellate Division, First Department, ruled that no private cause of action exists under section 352-c of the Martin Act.⁸

In *CPC International*, the plaintiff CPC International, Inc. ("CPC"), submitted the highest bid for the C.F. Mueller Company ("Mueller"), which was accepted by Mueller's parent company, defendant McKesson Corporation ("McKesson").⁹ Direct negotiations for a contract of sale followed between executives of both companies, and, at the request of the plaintiff, McKesson warranted that Mueller's projected sales and profits disclosed to CPC were made in good faith and in the ordinary course of business.¹⁰ Subsequent to CPC's purchase of the pasta company, Mueller's business declined,¹¹ and CPC commenced an action against several defendants, asserting five different causes of action, including violations of section 352-c of the Martin Act.¹² Trial Term denied the

This injunctive relief proved to be inadequate to protect the public from fraud. N.Y. GEN. BUS. LAW § 352, commentary at 8 (McKinney 1984). Section 352-c now allows the attorney general to affirmatively prosecute any violations of its enumerated fraudulent practices in criminal court. See *Charles H. Greenthal & Co., Inc. v. Lefkowitz*, 32 N.Y.2d 457, 463, 299 N.E.2d 657, 658-59, 346 N.Y.S.2d 234, 236-37 (1973).

⁶ See *Lupardo v. I.N.M. Indus. Corp.*, 36 F.R.D. 438 (S.D.N.Y. 1965). The *Lupardo* court recognized that "[t]he Blue Sky Laws of New York have no express private civil liability provisions of any kind." *Id.* at 439; see also N.Y. GEN. BUS. LAW § 352, commentary at 27 (McKinney 1984) (Martin Act silent on whether private litigant may maintain civil action based on violation of statute).

⁷ 120 App. Div. 2d 221, 507 N.Y.S.2d 984 (1st Dep't 1986).

⁸ See *id.* at 236, 507 N.Y.S.2d at 993; see also Fox, *Private Cause of Action Barred Under New York Securities Law*, N.Y.L.J., Nov. 17, 1986, at 1, col. 3 (explaining ruling of *CPC International* on private cause of action under Martin Act).

⁹ See 120 App. Div. 2d at 226, 507 N.Y.S.2d at 985-86. In 1983, McKesson decided to sell Mueller and sent to bidders an Offering Memorandum prepared by Morgan Stanley & Co., Inc., McKesson's financial advisor. *Id.* at 224, 507 N.Y.S.2d at 985. The memo contained information relative to Mueller's financial performance with projections as to Mueller's future sales and profits. *Id.* Bidders, including CPC, visited Mueller's headquarters in New Jersey for a one day presentation. *Id.* at 225, 507 N.Y.S.2d at 986. In October, 1983, CPC submitted the highest bid for Mueller, which was approximately \$124 million. *Id.*

¹⁰ *Id.* at 226, 507 N.Y.S.2d at 986-87. During the negotiations, CPC's attorneys demanded that the projections of sales and profits be included in the contract of sale as representations and warranties. *Id.* McKesson refused, but ultimately warranted that the projections were made in good faith. *Id.*

¹¹ *Id.* at 227, 507 N.Y.S.2d at 987. CPC and McKesson closed the transaction on November 30, 1983, with CPC purchasing the Mueller stock for \$124.3 million. *Id.* It is undisputed that subsequent to CPC's purchase Mueller's business declined. *Id.*

¹² *Id.* Approximately eighteen months after it purchased Mueller, CPC commenced an action alleging breach of express warranties and fraud. *Id.* The action was brought against

motions to dismiss the asserted violations of section 352-c, ruling that a private right of action existed under that section of the Martin Act.¹³

The Appellate Division, First Department, reversed the decision below, holding "that to imply a private cause of action under [section] 352-c [of the Martin Act] is inconsistent with the Legislature's statutory scheme."¹⁴ Justice Ross, writing for a unanimous panel, declared that the court was not bound by the prior decisions of federal district and appellate courts that had implied that a private right of action exists under section 352-c.¹⁵ The court applied the reasoning delineated in *Burns Jackson v. Lindner*,¹⁶ stating "that before a private right of action can be read into a statute it is necessary to establish whether the Legislature clearly intended to provide this kind of remedy."¹⁷ After examining the 1955 Attorney

McKesson, Corp-Am (Corporation of America, a subsidiary of McKesson that held the Mueller stock), Mr. Blattman, Mr. Merrick and Mr. Brounstein (officers of McKesson or Mueller), and Morgan Stanley & Co., Inc. *Id.*

The first and second causes of action alleged breaches of express warranties, and the third cause of action alleged common law fraud, all arising from McKesson's projection of future sales and profits. *Id.* The fourth cause of action, which this Survey will address, alleged violations of section 352-c of the Martin Act. *Id.* The fifth cause of action alleged violations of section 17(a) of the federal Securities Act of 1933, 15 U.S.C. § 77q(a) (1982). *Id.*

¹³ See *id.* at 229, 507 N.Y.S.2d at 988. In making its ruling, Trial Term relied on *Barnes v. Peat, Marwick, Mitchell & Co.*, 69 Misc. 2d 1068, 332 N.Y.S.2d 281 (Sup. Ct. Spec. T. N.Y. County 1972), *modified on other grounds*, 42 App. Div. 2d 15, 344 N.Y.S.2d 645 (1st Dep't 1973). In *Barnes*, the court, faced with a similar question, denied a defendant's motion to dismiss a civil cause of action alleging a violation of section 352-c of the Martin Act. See 69 Misc. 2d at 1072, 332 N.Y.S.2d at 285. Relying on a federal district court decision and several trial court decisions in New York, the *Barnes* court held that "the better rule . . . is to permit a private claim for relief" under section 352-c. See *id.* (citation omitted); see also *infra* notes 15, 22-26 and accompanying text (discussion of private claim for relief under section 352-c).

¹⁴ *CPC Int'l*, 120 App. Div. 2d at 236, 507 N.Y.S.2d at 993.

¹⁵ See *id.* During the past twenty-one years, a number of decisions have held that an implied cause of action exists for purchasers of securities who are injured by violations of section 352-c of the Martin Act. See *Whitbread (US) Holdings, Inc. v. Baron Philippe de Rothschild, S.A.*, 630 F. Supp. 972, 984-85 (S.D.N.Y. 1986); *Herzfeld v. Laventhol, Krekstein, Horwath & Horwath*, 378 F. Supp. 112, 129-30 (S.D.N.Y. 1974), *aff'd in part, rev'd in part*, 540 F.2d 27 (2d Cir. 1976); *Lupardo v. I.N.M. Indus. Corp.*, 36 F.R.D. 438, 439 (S.D.N.Y. 1965).

¹⁶ 59 N.Y.2d 314, 451 N.E.2d 459, 464 N.Y.S.2d 712 (1983).

¹⁷ *CPC Int'l*, 120 App. Div. 2d at 231, 507 N.Y.S.2d at 990. The test espoused by the Court of Appeals in *Burns Jackson* to determine if a private right of action exists consists of three parts:

Whether a private cause of action was intended will turn in the first instance on whether the plaintiff is "one of the class for whose especial benefit the statute was enacted". . . . Important also are what indications there are in the statute or its legislative history of an intent to create (or conversely to deny) such a remedy

General's Memorandum in support of amendments to the Martin Act, Justice Ross found that it was the attorney general's intent to recommend the enactment of section 352-c for the sole purpose of enlarging the attorney general's enforcement powers, and not to establish a private right of enforcement.¹⁸ In addition, the court concluded that neither the legislature nor the governor had contemplated such a right, and found "conclusively that it was consistent with the purposes underlying the legislative scheme . . . not to give the public a private right of action."¹⁹

It is submitted that the court in *CPC International* set back decades of progress made by federal and state court decisions²⁰ which implemented the desired goals of the Martin Act.²¹ As early as 1965, courts had begun to imply a private right of action in section 352-c in order to effectuate the statute's purpose of "protect[ing] the public against fraud in the sale of securities."²² A

and, most importantly, the consistency of doing so with the purposes underlying the legislative scheme.

Burns Jackson, 59 N.Y.2d at 325, 451 N.E.2d at 463, 464 N.Y.S.2d at 716 (citations omitted).

The *CPC Int'l* opinion also cited the Supreme Court case of *Cort v. Ash*, 422 U.S. 66 (1975), see 120 App. Div. 2d at 232, 507 N.Y.S.2d at 990, which stated that a private right of action could not be read into a statute unless there was clear evidence that it was the legislature's intent to create such a right. See 422 U.S. at 82.

¹⁸ See *CPC Int'l*, 120 App. Div. 2d at 236, 507 N.Y.S.2d at 993; Memorandum, *supra* note 4, at 135.

¹⁹ *CPC Int'l*, 120 App. Div. 2d at 236, 507 N.Y.S.2d at 993 (citations omitted); see Letter from the National Association of Securities Dealers, Inc. to Governor W. Averell Harriman (Apr. 5, 1955), Governor's Bill Jacket, L.1955, ch. 553, at 8 (proposed amendments were meant to "give the Attorney General's office the statutory powers . . . necessary to accomplish the purposes of the law"); Letter from the Investment Bankers Association of America to Governor W. Averell Harriman (Apr. 5, 1955), Governor's Bill Jacket, L. 1955, ch. 553, at 12 (attorney general's office should have powers necessary to accomplish purposes of law).

²⁰ See *supra* note 15 and accompanying text; *infra* notes 22-29. Other courts have ruled on issues relating to violations of the Martin Act in actions brought by individuals, and in doing so predicated their rulings on the determination that a private cause of action exists under the Martin Act. See, e.g., *Bennett v. United States Trust Co.*, 770 F.2d 308, 315-16 (2d Cir. 1985) (private plaintiff did not meet Martin Act requirement of showing proximate causal connection between wrongdoing and damages), *cert. denied*, 106 S. Ct. 800 (1986); *Schenck v. Bear, Stearns & Co.*, 484 F. Supp. 937, 946 (S.D.N.Y. 1979) (section 352-c provides private cause of action, though not applicable to particular case); *Herdegen v. Paine, Webber, Jackson & Curtis*, 31 Misc. 2d 104, 105, 220 N.Y.S.2d 459, 460 (Sup. Ct. N.Y. County 1961) (implying private cause of action, though inapplicable to facts in case).

²¹ See *infra* notes 22-29 and accompanying text.

²² *Lupardo v. I.N.M. Indus. Corp.*, 36 F.R.D. 438, 439 (S.D.N.Y. 1965) (citation omitted). *Contra Stein v. Morey*, N.Y.L.J., Jan. 10, 1967, at 17, col. 1 (Sup. Ct. N.Y. County 1967) (nothing in act gives rise to a private civil action).

clear judicial trend had developed by 1974 when the federal district court in *Herzfeld v. Laventhol, Krekstein, Horwath & Horwath*,²³ considering state and federal court decisions, the purpose of the statute, and policy reasons, concluded that section 352-c authorizes a private right of action by a person injured by its violation.²⁴ It is suggested that in denying the plaintiff a private right of action, the court in *CPC International* failed to reconcile its holding with previous case law and public policy.²⁵ Additionally, the court in *CPC International* did not fully discuss an Appellate Division, First Department decision which seemingly affirmed a lower court's acceptance of a private right of action under the Martin Act.²⁶

The primary purpose of the Martin Act, preventing fraud in connection with the sale of securities and commodities to the public,²⁷ may have been severely hindered by the court's ruling in *CPC International*. By denying a private person the right to bring a cause of action under section 352, as a supplement to the attorney

²³ 378 F. Supp. 112 (S.D.N.Y. 1974), *aff'd in part, rev'd in part*, 540 F.2d 27 (2d Cir. 1976).

²⁴ See *id.* at 129-130. The *Herzfeld* court relied on *Barnes v. Peat, Marwick, Mitchell & Co.*, 69 Misc. 2d 1068, 332 N.Y.S.2d 281 (Sup. Ct. N.Y. County 1972), *modified on other grounds*, 42 App. Div. 2d 15, 344 N.Y.S.2d 645 (1st Dep't 1973), which stated that "statutes which on their face provide penal sanctions also imply a private right of action. . ." *Id.* at 1070, 332 N.Y.S.2d at 283. *Herzfeld* declared that it was New York's policy "to imply a civil cause of action from a criminal statute designed to protect the public. . ." *Herzfeld*, 378 F. Supp. at 130. The court was also influenced by federal court decisions which reached similar conclusions regarding this issue. See *id.*; *American Bank & Trust Co. v. Barad Shaff Sec. Corp.*, 335 F. Supp. 1276, 1283 (S.D.N.Y. 1972); *Lupardo v. I.N.M. Indus. Corp.*, 36 F.R.D. 438 (S.D.N.Y. 1965).

²⁵ See *CPC Int'l*, 120 App. Div. 2d at 235-36, 507 N.Y.S.2d at 992-93. The *CPC International* court discussed the *Barnes* decision, see *supra* note 24, but noted that *Barnes* was decided before *Burns Jackson and Cort*, see *supra* note 17, which provide the test to determine whether the legislature intended to create a private cause of action under a statute. See 120 App. Div. 2d at 235-36, 507 N.Y.S.2d at 992-93. The *CPC International* court applied this test and determined that no such remedy exists under the Martin Act. See *id.* The court failed to explain why it was not following prior cases which allowed a private cause of action, nor did it distinguish cases which found that a private cause of action existed from those that did not. See *id.*; see also N.Y. GEN. BUS. LAW § 352-c, commentary at 27 (McKinney 1984) (prevailing judicial opinion is that private cause of action exists under Martin Act).

²⁶ See *Barnes v. Peat, Marwick, Mitchell & Co.*, 42 App. Div. 2d 15, 344 N.Y.S.2d 645 (1st Dep't 1973); see also *supra* notes 24 and 25 and accompanying text.

²⁷ See *supra* note 2 and accompanying text; see also N.Y. GEN. BUS. LAW § 352, commentary at 9 (McKinney 1984) (purpose of Act is protection of public from fraudulent exploitation).

general's enforcement powers,²⁸ the court has taken much of the bite out of the statute's desired effect.²⁹ Allowing a right of action to private litigants would substantially aid the attorney general in enforcement of the Martin Act. The *CPC International* court, instead, accorded little weight to public policy considerations and trends in case law in concluding that a civil cause of action did not exist under New York's "blue sky" law. As a result, the goal of the Martin Act, to protect the public from fraudulent exploitation, may not be achieved to the fullest extent possible under the statute.

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²⁸ See, e.g., 1 A. BROMBERG & L. LOWENFELS, *SECURITIES FRAUD AND COMMODITIES FRAUD* § 2.4, at 126 (1982) (discussing need for private enforcement as supplement to SEC enforcement).

²⁹ Presently, there are great problems enforcing securities regulation. See Long, *State Securities Regulation — An Overview*, 32 OKLA. L. REV. 541, 542 (1979). In 1955, New York recognized that it needed to adapt its laws to combat the securities fraud problem. See Memorandum, *supra* note 4, at 135. However, it is submitted that the *CPC International* court ignores the underlying reason for the 1955 amendment of the Martin Act in its rationale. New York needed new legislation to combat the modern schemes of securities fraud and wanted to model its statute to conform more closely to those of progressive states which recognized private actions. See Memorandum, *supra* note 4. Consistent with this view, the court in *Gardner v. Lefkowitz*, 97 Misc. 2d 806, 412 N.Y.S.2d 740, 746 (Sup. Ct. N.Y. County 1978), stated that the Martin Act "should be given a pliable yet resilient construction enabling [it] to be applied to individual situations in a manner which best fulfills [its] beneficial purpose." *Id.* at 813, 412 N.Y.S.2d at 746. The holding in *CPC International* construes the Martin Act in a narrow manner and thus may present difficulties for the practitioner of securities law in New York.