The Investigative Authority of the New York Attorney General Is Not Without Its Limits

Much press ink has been spilled announcing yet another investigation or enforcement action by the New York Attorney General, ranging from Attorney General Spitzer’s actions against major Wall Street financial institutions and their executives, to Attorney General Cuomo’s actions against banks, investment advisors and brokerages regarding mortgage-backed securities, and Attorney General Schneiderman’s recent actions against energy companies regarding their climate risk disclosures. These headlines do not simply reflect New York’s status as an international media capital and one of the few remaining tabloid towns. They arise as well from certain statutory tools the New York Attorney General has at his disposal, which the Attorney General’s Office views quite expansively.

The Attorney General’s investigative powers are, indeed, quite broad. But they are not without limits, and recipients of overly broad or inappropriate investigative subpoenas do have some resources at their disposal to limit or even quash such subpoenas if the Attorney General overreaches.

The New York Attorney General’s Enforcement Powers Under The Martin Act

We have previously written about the New York Attorney General’s expansive enforcement powers under New York’s Martin Act.¹ The Martin Act broadly regulates the advertisement, issuance, exchange, purchase or sale of securities, commodities and certain other investments within or from New York. It authorizes the Attorney General to conduct investigations of potential securities or commodities fraud, and to bring civil or criminal actions against alleged violators of the Act.² To that end, the Martin Act vests the New York Attorney General with a wide variety of enforcement powers, including the power to:

• Commence investigations (public or confidential) into potentially fraudulent practices (N.Y. Gen. Bus. Law §§ 352, 354-55)
• Initiate civil proceedings for injunctive relief or restitution
• Initiate criminal actions (N.Y. Gen. Bus. Law § 358)
• Issue subpoenas statewide to compel attendance of witnesses or to require production of documents in connection with an investigation (N.Y. Gen. Bus. Law § 352(2))

Notably, the Martin Act contains no scienter requirement. Courts interpreting the statute have held that the Attorney General does not need proof of an intent to deceive or defraud to begin an investigation or, for that matter, even to initiate an enforcement action. Unlike many federal securities fraud statutes or common law fraud, “to establish liability for fraudulent practices in an enforcement action proceeding under the Martin Act, the Attorney General need not allege or prove either scienter or intentional fraud.” Instead, New York courts have held that liability can attach to an unintentionally false statement that has induced no reliance but merely “has a potential to deceive.” The breadth of the statute is coupled with the broad scope of the Attorney General’s investigative power. Courts have held that the Attorney General need only show that an investigative subpoena is “relevant” and that the investigation has “some factual basis.” In fact, some courts have gone so far as to hold that a witness has no right to have an attorney present during his or her investigative testimony or to have access to a copy of the transcript of his or her testimony.

Investigations and enforcement actions under the Martin Act extend beyond transactions involving securities as they are commonly understood. Based on the United States Supreme Court’s expansive definition of a “security” in Securities and Exchange Commission v. W. J. Howey Co. and its progeny, a broad array of investments have been considered securities for purposes of the Martin Act. For example, mortgage notes, a membership interest in a real estate venture, and an interest in a “numismatic coin portfolio” have all been deemed securities within reach of the Martin Act.

However, while the definition of a security may be broad it is not all-encompassing. For example, whether foreign exchange transactions constitute “foreign currency orders” included within the ambit of the Martin Act remains an unsettled question. In Lehman Bros. Commercial Corp. v. Minmentals Int’l. Non-Ferrous Metals Trading Co., for instance, the court held that FX transactions were not securities under New York’s Martin Act because they did not satisfy the commonality prong under the Howey test. Similarly, in People v. Bank of New York Mellon Corp., the court stated that a more developed record was required to determine whether foreign exchange transactions are securities within the Martin Act.

On the other hand, the text of the Martin Act itself “provides the regulatory framework governing the offer and sale of securities, commodities and other investment vehicles in and from New York,” and thus the statute might be construed to encompass more esoteric transactions, such as FX trades.

The unsettled law regarding the reach of the Martin Act as applied to foreign currency transactions has not deterred current Attorney General Schneiderman. He has reportedly issued investigative subpoenas to a number of brokers involved in foreign exchange trading.

Additional Martin Act actions brought under New York Attorneys General Spitzer, Cuomo and Schneiderman include the investigation of banks concerning the promotion of internet stocks, the investigation of the compensation packages of certain executives, and the 2011 suit Attorney General Schneiderman brought against Bank of New York Mellon over foreign exchange fees. Significantly, Martin Act investigations have increased ten-fold under the reign of recent New York Attorneys General. These include Attorney General Cuomo’s investigation of an alleged “pay-to-play” scheme at the New York Office of the State Comptroller during the tenure of Comptroller Alan Hevesi and the subsequent indictment of several Comptroller office employees, and Attorney General Schneiderman’s widely publicized investigative subpoena served upon Airbnb, the well-known website that allows people to list, find, and rent housing for short-term periods.

More recently, Attorney General Schneiderman issued a subpoena to an international energy company, purportedly seeking documents concerning what the company knew about climate change risks and whether this information was shared with investors and the public. This investigative subpoena came close in time to the announcement of a settled enforcement action against another energy company regarding its own statements to the public and investors regarding climate change and potential regulatory responses.
Additional Enforcement Tools at the Disposal of The New York Attorney General

The New York Attorney General’s statutory power extends beyond the Martin Act. In recent years, the New York Attorney General has pursued civil and criminal enforcement actions under provisions of New York’s Executive Law and General Business Law, which the Attorney General’s office, and often the courts, interpret very broadly.

New York’s Executive Law. Section 63(12) of New York’s Executive Law authorizes the New York Attorney General to investigate and to bring an enforcement action against “persistent fraud or illegality in the carrying on, conducting, or transaction of business.” A New York trial court has recently held that Section 63(12) “does not create an independent cause of action but rather provides the AG with standing to seek redress and specific remedies against fraudulent or otherwise illegal behavior.” The New York Attorney General has appealed that decision, arguing that Section 63(12) does provide an independent claim for fraud and need not be tethered to a separate statutory or common law fraud claim.

The Attorney General’s investigative powers under Section 63(12) include issuing investigative subpoenas for documents and witness testimony. Under the terms of Section 63(12), “fraudulent conduct” includes “any device, scheme or artifice to defraud and any deception, misrepresentations, concealment, suppression, false pretense, false promise or unconscionable contractual provision.” New York courts interpreting the Executive Law have found that proof of fraud or deceptive conduct under Section 63(12) requires only a “capacity or tendency to deceive.” It does not require the Attorney General to establish the elements of common law fraud, including scienter. “Illegality” is also defined broadly under Section 63(12) to include violations of state and local laws and regulations, including violations of New York’s consumer fraud statutes (discussed below) as well as violations of federal laws or regulations. Moreover, the requirement that the fraudulent or illegal activity be “persistent” to date has rarely been a difficult bar for the New York Attorney General to surmount, putting very few acts beyond the New York Attorney General’s reach under the Executive Law.

Some noteworthy Section 63(12) enforcement actions pursued by the New York Attorney General include Attorney General Schneiderman’s recently filed complaint against DraftKings and FanDuel, two daily fantasy sports websites, regarding their alleged acceptance of wagers from residents of New York State in purported violation of state law. Schneiderman filed the action in November 2015 seeking an injunction to enjoin these sites from operating within the state. The injunction Schneiderman sought was granted, which would have required both websites to cease operations within the state. The ruling was quickly challenged, however, and both companies are continuing operations under an interim stay granted by the New York Appellate Division pending a hearing on the injunction. The Attorney General has also previously used his enforcement power under Section 63(12) in a number of actions brought against companies accused of repeated antitrust violations, such as bid-rigging and monopolization.

New York’s General Business Law. The New York Attorney General also has the power to enjoin deceptive consumer practices or to initiate enforcement actions against any person or business that engages in deceptive acts or practices or false advertising pursuant to General Business Law (“GBL”) Sections 349 and 350. These statutes, which are “broadly applicable and liberally construed,” have been invoked against a variety of economic activities. Moreover, as with the Martin Act, there is no scienter requirement—that is, the New York Attorney General need not prove that the deceptive practice or false advertising was intentional or even reckless.

The Attorney General’s powers under the GBL are broader than those the statute gives to private plaintiffs. To succeed in a Section 349 action, a private plaintiff must show that the act or practice was consumer-oriented, that it was misleading in a material respect, and that the plaintiff was injured as a result of the deception. Similarly, a private plaintiff bringing a Section 350 claim must show that the advertisement was consumer-oriented, that the advertisement was misleading in a material respect, and that the plaintiff was injured as a result of the allegedly misleading advertisement. The Attorney General, on the other hand, is not required to demonstrate actual injury. In addition, the Attorney General may initiate an enforcement action...
to enforce the consumer protection laws on behalf of the general public, while a private plaintiff lacks the power to bring an action pursuant to GBL Sections 349 and 350 on the grounds of general "consumer injury or harm to the public interest." Further, unlike a private plaintiff, the Attorney General is not required to show consumer reliance on, or actual deception of the consumer by, the allegedly deceptive act, practice or advertisement.

The Attorney General also has the power to seek more expansive remedies for violations of GBL Sections 349 and 350 than a private plaintiff could obtain. For example, the Attorney General may obtain injunctive relief (including preliminary injunctive relief), restitution, and civil penalties of up to $5,000 per violation. Private plaintiffs, by contrast, may bring an action only to enjoin an alleged unlawful practice or advertisement and recover actual damages, or damages up to $50 for Section 349 violations and $500 for Section 350 violations.

Consumer protection actions the New York Attorney General has pursued under GBL Sections 349 and 350 have included the investigation of, and actions against, the recorded music industry regarding certain practices in promoting new music to radio stations (resulting in settlements with a number of industry participants), and the investigation of several of the largest nationwide health insurers regarding purported rate manipulation, allegedly resulting in overcharging patients.

**Responding to New York Attorney General Investigative Subpoenas**

An investigative subpoena served by the New York Attorney General warrants the same care, and practical steps, that a subpoena in the more usual context—a civil lawsuit—requires. Thus, as with any subpoena, counsel should first ensure that the client properly implements a sufficient hold on potentially responsive electronic and hardcopy documents. At the outset, counsel should also, as with any law enforcement subpoena, contact the attorney at the New York Attorney General's Office who issued the subpoena in an attempt to learn what they can about the investigation underlying the subpoena, and why the client received it. Counsel should also seek as necessary to clarify ambiguous requests, narrow requests that suffer from over-breadth, and seek an appropriate extension of any deadline in the subpoena for production of responsive documents.

If efforts to appropriately narrow or clarify an investigative subpoena, or extend a subpoena deadline, are unsuccessful, the recipient of the subpoena is not without recourse. Counsel should consider pursuing a motion to quash or to modify the subpoena pursuant to Rule 2304 of New York's Civil Practice Law and Rules ("CPLR"). As with any discovery-related motion, a motion to quash a subpoena must be preceded by a good-faith effort to resolve the issues raised by the subpoena, as required by New York's local court rules, and the individual rules of many New York judges.

Although the CPLR does not specify a time within which a motion to quash or modify has been made, such a motion should generally be made "at or before the time specified in the subpoena for compliance therewith." Whether the recipient of an investigative subpoena from the New York Attorney General succeeds in subpoena negotiations or must resort to a motion to quash, the subpoena response or motion must preserve all applicable objections to the subpoena. Such objections might include procedural objections to requests that are vague or overbroad, or substantive objections to the extent the subpoena requests implicate legal privileges—such as the attorney-client, work product or common interest privileges—or privacy or constitutional protections, whether procedural or substantive.

If motion practice is necessary, there are authorities available to push back at the Attorney General's often-expansive views of the breadth of his power. While the courts have interpreted the Attorney General's power broadly, the Attorney General still must be able to show that the information sought with an investigative subpoena "bear[s] a reasonable relation to the subject matter under investigation and to the public purpose to be achieved." Thus, at the very least, while the courts may be "slow to strike down [a subpoena]," the Attorney General "does not...have arbitrary and unbridled discretion as to the scope of his investigation" and may not require production of materials "utterly irrelevant to any proper inquiry." Under these standards, "the law requires that some factual basis be
demonstrated to support a subpoena”; that is, “the agency asserting its subpoena power must show ‘some basis for inquisitorial action,’” although the showing need not reach the level of probable cause.42 So while cases limiting the Attorney General’s investigative powers may be sparse, it is nonetheless established that “no agency of the government may conduct an unlimited and general inquisition into the affairs of persons within its jurisdiction solely on the prospect of possible violations of law being discovered[,]”43

Even if there is a colorable factual basis for a New York Attorney General subpoena that gets past this first substantive hurdle, that does not open the gates to an unlimited inquiry. The recipient may, in appropriate circumstances, challenge the scope of the subpoena if it is too broad. The New York Court of Appeals, for example, has struck down regulatory subpoenas calling for “all books and records concerning [the subject company’s] operations” as an “unlimited examination of the business affairs of an enterprise.”44 Therefore, in appropriate cases, the courts should at least narrow subpoenas that are overly broad or are a classic “fishing expedition.”45

The Attorney General’s underlying legal theory may also present a basis for challenging an investigatory subpoena. Notwithstanding the broad investigatory powers conferred by statutes such as Executive Law § 63(12), the investigations have to be based upon “possible violations of law.”46 Thus, the recipient of a New York Attorney General subpoena may want to consider whether arguments challenging the Attorney General’s legal premises are appropriate and ripe.47 By way of example, if—as appears to be so with the Attorney General’s recent subpoenas addressed to “climate change” issues—the Attorney General delves into areas that are more matters for political debate than they are for legal liability, there may be a valid constitutional challenge to be asserted. Only “commercial” speech can be constitutionally regulated, and even then only as long as any restriction “directly advance[s] the state interest involved” and the governmental interest could not be adequately “served by a more limited restriction.”48

Conclusion

The Martin Act, Executive Law Section 63(12), and New York GBL Sections 349 and 350, along with certain additional New York statutory provisions, combine to grant the New York Attorney General broad authority to investigate and pursue civil and criminal enforcement actions related to allegedly fraudulent or deceptive and misleading practices involving securities, commodities and other financial and consumer transactions. The absence in these provisions of certain basic procedural and substantive protections, at least as interpreted by the New York Attorney General and some New York courts—and the aggressive manner in which a succession of New York Attorneys General have chosen to apply them—underscores the need for counsel representing an individual or entity served with an Attorney General investigative subpoena to consider challenging the propriety of the Attorney General’s conduct on procedural or substantive grounds. Such a response may include a motion to quash a subpoena in which procedural or substantive constitutional claims, along with other appropriate claims and objections, could be raised. Further scrutiny of the New York Attorney General’s enforcement program on these grounds by New York and federal trial and appellate courts is overdue.

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our “Contact Us” form, which can be found at www.jonesday.com/contactus/.

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Endnotes

3 State v. Rachman Corp., 71 N.Y.2d 718, 725 n.6 (N.Y. 1988).
7 In Howey, the Supreme Court held that an investment is considered a security if there is “an investment of money in a common enterprise with profits to come solely from the efforts of others.” S.E.C. v. W.J. Howey Co., 328 U.S. 293, 301 (1946).
8 See, e.g. All Seasons Resorts, Inc. v. Abrams, 68 N.Y.2d 81 (N.Y. 1986). People v. First Meridian Planning Corp., 86 N.Y.2d 608 (N.Y. 1990); see also Orestes J. Mihaly & David J. Kaufmann, Practice Commentaries, McKinney’s Cons Laws of NY, Book 19, General Business Law art 23-A at 16 [1996 ed.] (“Judicial decisions construing the term ‘security’ as used in the Martin Act maintain that the reach of the statute does not stop with the obvious and the commonplace. Novel, unconnected or irregular devices, whatever they are called or however they are made to appear, are also encompassed if it is proved that they were offered to the public or dealt in under the terms which established their character as speculative ‘evidence of interest’ which are, in fact, ‘securities.’”).
10 People ex rel. Schneideman v. Bank of New York Mellon Corp., 40 Misc. 3d 1232(A) (N.Y. Sup. Ct. 2013) (denying defendant’s motion to dismiss on the grounds that a more extensive record was needed to determine whether the standing instruction transactions at issue are securities).
16 Executive Law § 63(12).
17 People v. The Trump Entrepreneur Initiative LLC, 2014 N.Y. Misc. LEXIS 4533, at *7 (N.Y. Sup. Ct. 2015); People v. Barclays Capital, Inc., 47 Misc. 3d 862, 871 (N.Y. Sup. Ct. 2015) (“Executive Law 63(12) does not create independent claims, but merely authorizes the Attorney General to seek injunctive and other relief on notice prescribed by the statute in cases involving persistent fraud or illegality.”) (internal citations omitted).
19 Executive Law § 63 (12).
22 New York v. Princess Prestige, 42 N.Y.2d 104 (N.Y. 1977) (deceptive practices in only 16 out of 3600 transactions found sufficient to establish “repeated” conduct element of section 63 (12)).
36 Gen. Bus. Law §§ 349(h), 350-e. The statute also authorizes a plaintiff to seek treble damages in appropriate situations.
also has claimed broad power over corporations operating within New York through New York Business Corporation Law ("BCL") Section 1303, which authorizes the Attorney General to bring an action or special proceeding to enjoin the actions, or annul the authority of, a foreign corporation operating contrary to state law in a manner that, if done by a domestic corporation, would be a cause for its dissolution under BCL 1101. See Complaint at 27, People v. DraftKings, No. 453054/2015 (N.Y. Sup. Ct. Nov. 17, 2015).

38 CPLR § 2304.

39 McKinney's Practice Commentary C2304:3.


41 Id.


45 Airbnb, supra note 42 at 359 ("While petitioner bears the burden of demonstrating that the subpoena is overbroad, as petitioner argues, a plain reading of the subpoena in light of Multiple Dwelling Law § 4 and the tax provisions and materials at issue meets such burden. Based upon the foregoing, the subpoena at issue, as drafted, seeks materials that are irrelevant to the inquiry at hand and accordingly, must be quashed.").


47 See Airbnb, supra note 42, at 360 (acknowledging void for vagueness challenge on constitutional grounds but finding issue not yet ripe for review).

48 Cent. Hudson Gas and Elec. Co. Pub. Srv. Comm'n, 447 U.S. 557, 563 (1980). Though beyond the scope of this Commentary, defendants named in a New York Attorney General civil enforcement Complaint are similarly not without recourse to aggressively challenge Attorney General claims or requested relief that exceed constitutional and other limits. For example, Article 78 of the CPLR provides a mechanism for a defendant or respondent to challenge conduct by a New York governmental agency alleged to be beyond the agency's jurisdiction, or that is "arbitrary and capricious" or an abuse of discretion. In cases where the New York Attorney General's conduct in initiating an enforcement action runs the risk of irreparable harm to an individual or business, an Article 78 proceeding could be accompanied by requests for declaratory and injunctive relief. Such a proceeding could also provide a vehicle to raise substantive or procedural constitutional claims under both the United States and New York Constitutions, or other appropriate claims.