

Client Alert

Latham & Watkins
Litigation Department

New York Commercial Division Strikes Down New York Attorney General's Martin Act Claim for Disgorgement Against Ernst & Young LLP

On December 12, 2012, a team of attorneys from Latham & Watkins LLP won dismissal of the New York Attorney General (NYAG)'s Martin Act claim against Ernst & Young LLP (EY) for disgorgement of \$150 million of fees that it alleged Lehman Brothers paid to EY.¹ The NYAG historically has relied on claims for disgorgement to pursue large sums from defendants alleged to have violated the Martin Act,² the antifraud blue sky law that came into favor during Eliot Spitzer's tenure as Attorney General. The NYAG recognized that because private plaintiffs were already pursuing damages in a previously filed federal securities class action, the remedies of restitution and damages ultimately would likely not be available to the NYAG. The importance of this ruling, issued by New York Commercial Division Justice Jeffrey K. Oing, is that as a practical matter, in cases where defendants did not receive funds directly from investors, it may preclude the NYAG from recovering substantial monetary relief under the Martin Act.

On December 21, 2010, the NYAG filed a civil action against EY in New York state court, alleging that the auditor violated the Martin Act and the New York Executive Law³ in connection with its audits of Lehman Brothers. The NYAG filed its complaint several months after the filing of a putative class action lawsuit in the Southern District of New York, in which plaintiffs alleged that EY violated federal securities laws in connection with its audits and reviews of Lehman Brothers.⁴ The vast bulk of the claims against EY in the securities class action lawsuit were then dismissed.⁵ The NYAG's complaint against EY sought restitution and damages for shareholder losses and injunctive relief, all of which are express remedies (in appropriate circumstances) under the plain language of the Martin Act and the Executive Law. Beyond those remedies, the NYAG also asserted a claim for disgorgement of the professional fees Lehman paid to EY during the period from 2001 to 2008, a measure of relief not expressly provided in the statutes or available to the class action plaintiffs.

In moving to dismiss the disgorgement claim, EY argued that (1) the New York Legislature expressly provided for a wide range of compensatory remedies, including the equitable remedy of restitution, but did not provide for the non-compensatory (*i.e.*, punitive) remedy of disgorgement, (2) the legislative history of the statutes, New York law on statutory construction and relevant case law did not

"After hearing oral arguments on EY's motion, Justice Oing issued a bench ruling in which he rejected the NYAG's argument that disgorgement is ancillary to the NYAG's injunctive relief claims authorized by the statutes, and dismissed the NYAG's claim for disgorgement of EY's fees as an improper claim for punitive relief."

permit the NYAG to read additional remedies into the Martin Act or Executive Law and (3) the NYAG does not have the authority to appropriate EY's professional fees and pay them into the State Treasury.

After hearing oral argument on EY's motion, Justice Oing issued a bench ruling in which he rejected the NYAG's argument that disgorgement is ancillary to the NYAG's injunctive relief claims authorized by the statutes, and dismissed the NYAG's claim for disgorgement of EY's fees as an improper claim for punitive relief.

For further information on this decision, please contact Miles N. Ruthberg, Jamie L. Wine, or James E. Brandt.

Endnotes

¹ *People of the State of New York v. Ernst & Young LLP*, Index No. 451586/2010, bench ruling (Sup. Ct. N.Y. Co. Dec. 12, 2012).

² N.Y. Gen. Bus. Law §§ 352-353 *et seq.*

³ N.Y. Exec. Law § 63(12).

⁴ *In re Lehman Bros. Equity/Debt Sec. Litig.*, 08-CV-5523-LAK (S.D.N.Y.).

⁵ *In re Lehman Bros. Sec. & ERISA Litig.*, 799 F. Supp. 2d 258 (S.D.N.Y. 2011).

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