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NEW YORK COURT OF APPEALS ROUNDUP:

ON FEDERAL PREEMPTION, GRASSO COMPENSATION LITIGATION

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AUGUST 14, 2008

Federal preemption has been a subject of much examination lately, including by the U.S. Supreme Court.[1] The Court of Appeals had the opportunity to address the issue recently in an action by the attorney general, deciding that the Executive Law and Consumer Protection Act claims therein were not preempted.

The Court, in its decision discussed below, also found that certain of the attorney general's claims were barred by settlement of a class action, rejecting a position supported by 30 other attorneys general as amici.

In another decision, the Court dismissed the common-law causes of action that the attorney general had asserted against Richard A. Grasso, chairman and chief executive officer of the New York Stock Exchange (NYSE) from 1995-2003, challenging Mr. Grasso's compensation.

Finally, we discuss in other decisions in which the Court addressed the interplay between two whistleblower statutes, one applicable to employees generally and the other to health care service providers, and construed the Labor Law's waiver provision.

Federal Preemption

In *People ex rel. Spitzer v. Applied Card Systems Inc.*, the attorney general sought restitution, civil penalties, and injunctive relief for conduct surrounding credit card solicitation of consumers with "subprime" credit. The action was instituted under Executive Law §63(12), applicable to fraud, and General Business Law §§349, 350, the Consumer Protection Act. The complaint alleged that respondent Cross Country Bank (CCB) misrepresented both the limits on the cards that it issued and the effect that origination and annual fees would have upon the amount of credit initially available.

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One of CCB's defenses was that the federal Truth-in-Lending Act (TILA) preempted the claims, which arose under state law. In an opinion by Judge Carmen Beauchamp Ciparick, the Court determined that success in the attorney general's action would not "disrupt the federal scheme" of disclosure mandated by TILA and the regulation promulgated thereunder (Regulation Z), and held that the action could proceed.

There are three types of federal preemption: express, by implication, and "conflict" preemption, applicable when there is an "irreconcilable conflict" between federal and state law. *Applied Card Systems* raised the first. TILA provides at 15 U.S.C. §1610(e) that the statute "shall supersede any provision of the law of any State relating to the disclosure of information in any credit or charge card application or solicitation which is subject to the requirements of section 1637(c) of this title . . . ." Section 1637(c), in turn, mandates specific disclosures for credit card applications and solicitations, and authorizes the Federal Reserve Board of Governors to require additional disclosures by regulation. In determining whether 1610(e) expressly preempts New York regulation of the subject matter, the Court applied the presumption that Congress does not intend to supplant state law.

The opinion for the 5-1 majority (Judge Robert S. Smith took no part in the decision) held that "[p]reemption is limited . . . to laws that purport to alter the format, content, and manner of the TILA-required disclosures and those that require credit issuers to affirmatively disclose specific credit term information not embraced by TILA or Regulation Z." Further, the majority stated, the case did not present the question of whether a claim under either of the New York statutes at issue and based upon "specific 1637(c) disclosures" would be preempted, an assertion with which the dissent took issue. Instead, the Court found, the Executive Law and Consumer Protection Act did not require CCB to disclose anything; rather, it required CCB to refrain from engaging in fraud, deception, and misleading advertising when dealing with New Yorkers.

Judge Susan Philips Read dissented. The attorney general had taken the position in the action that "the overall impression" created by CCB's disclosures was fraudulent and misleading. Moreover, the only way for CCB to comply with the injunction issued by the Supreme Court against engaging in the deceptive and unlawful practices alleged in the petition, would be to make different and/or additional disclosures. Such a result ran contrary to Congress' intent to "occup[y] the entire field of cost-of-credit disclosures" by establishing a comprehensive disclosure scheme for this national industry. Judge Read believed that "section 1610(e) and the structure of TILA's regulatory scheme . . . belie any notion that a state may use its consumer protection laws to impost additional or different" disclosure.

Grasso Prevails

Few cases in recent times have drawn the media coverage of *People v. Grasso*, which was instituted by then-Attorney General Eliot Spitzer. The matter came to an abrupt end in a matter of seven days after the Court, on June 25, 2008, unanimously affirmed the dismissal of the nonstatutory causes of action in the case, and on July 1, the Appellate Division, First Department, dismissed the remaining claims, which arose under the Not-for-Profit Corporation

Law (N-PCL). Before the ink was dry on the Appellate Division's exhaustive opinion, Attorney General Andrew M. Cuomo declared the case "over." At the end of the day, Mr. Grasso retained his $139.5 million lump-sum payment and an additional $48 million in compensation payable over time under his 2003 contract with the NYSE, which until 2006 was a not-for-profit corporation.

There was an outcry and investigation following public disclosure of Mr. Grasso's compensation, leading to Mr. Grasso's resignation and causing the NYSE's interim chairperson, who had succeeded Mr. Grasso, to invite both New York's attorney general and the Securities and Exchange Commission (SEC) to pursue Mr. Grasso on behalf of the Exchange. The attorney general did so. The gravamen of his complaint was that the compensation was unreasonable, and had been born out of various breaches of fiduciary duty by members of the Compensation Committee of the NYSE, whom Mr. Grasso had hand-picked.

The four common-law and equitable claims had been sustained in the Supreme Court on the grounds that the attorney general had standing to sue in the public interest under the doctrine of parens patriae. By a 3-2 decision, the Appellate Division, First Department, reversed, holding that such claims arose out of rights given the attorney general under the N-PCL, but had been dressed-up to look like common-law claims. The Court of Appeals affirmed the dismissal.

The Court concluded that, based upon a side-by-side comparison with the N-PCL claims, the nonstatutory claims as alleged did not lie because they overrode the "fault-based scheme" for liability of officers and directors in the N-PCL, and in particular would have lowered the attorney general's burden of proof, denied Mr. Grasso the protections of the business judgment rule, and potentially deprived him of the right to trial by jury.

In the end, the Court, in an opinion by Chief Judge Judith S. Kaye, concluded that the attorney general was bound by the requirements imposed upon him by the Legislature, and that the size of Mr. Grasso's compensation package could not justify treading on the policy-making authority of the Legislature.

The remaining claims were dismissed by the Appellate Division (3-1), with a dissenting opinion that matched the breadth of the majority's opinion point-by-point. The principal issue, as seen by the majority, was whether the attorney general continued to have authority to prosecute claims after the NYSE became a for-profit entity. The majority held that he did not, because there no longer was a not-for-profit entity on benefit of which the action could be maintained.

Considering the amount and quality of judicial energy poured into this case over its life, including five decisions of the Appellate Division, the question arises whether the Court, in aid of giving the case a true final resting place, could have deferred the appeal under consideration until the Appellate Division had ruled on the statutory claims, so that an appeal from the latter determination could have been consolidated with the appeal concerning the nonstatutory claims. It is possible that such a course may have resulted in an appeal of the Appellate Division's ruling and a final judicial resolution of the fate of the N-PCL claims.

'Class Action Abuse'

The Court did uphold another of CCB's defenses, however. New York consumers had been provided with the opportunity to opt-in to a national class action filed in California against CCB and others, arising out of credit card practices through 2001. In approving the settlement and entering judgment in the action, the California court barred class members from pursuing any released claims against the defendants.

The attorney general argued that he was not in privity with the settling consumers, and thus was not bound by the judgment, because his "interest" in seeking restitution was "far broader than [the settling consumers'] individual pecuniary concerns." In this he was supported by the attorneys general of 30 other states, who expressed concern over "collusive and undervalued settlements" in class actions. The Court of Appeals was not persuaded. New York is obligated to accord the California judgment full faith and credit. Its courts, therefore, may not maintain an action on released claims brought either by the consumers or by one, such as the attorney general, suing on their behalf.

Whistleblower Statutes

Labor Law §740(7), a section of the Whistleblower Law, provides that "institution of an action" in accordance with the section "shall be deemed a waiver of the rights and remedies available under any other contract, collective bargaining agreement, law, rule or regulation or under the common law." One of the issues certified to the Court of Appeals by the U.S. Court of Appeals for the Second Circuit in *Reddington v. Staten Is. U. Hosp.*, was whether simultaneous filing of an untimely but subsequently withdrawn claim under Labor Law §740 and a timely claim under §741, the Health Care Whistleblower Law, triggers the waiver provision in §740(7). In a 5-1 decision (Judge Carmen Beauchamp Ciparick took no part in the decision), the Court ruled that it does not.

The plaintiff had filed an action in federal District Court asserting causes of action arising under federal, state and municipal antidiscrimination laws, the Fair Labor Standards Act, §§740 and 741, and the common law. She then amended her complaint to voluntarily dismiss certain claims, including her time-barred §740 claim. The court granted defendants' motion to dismiss the §741 claim, finding it waived by the filing of the §740 claim.

The Court of Appeals disagreed. It concurred with the District Court that, merely by filing her complaint, plaintiff had "instituted an action" arising under §740, and therefore triggered §740(7). As explained in Judge Susan Philips Read's opinion for the Court, however, unlike the Whistleblower Law, the Health Care Whistleblower Law does not explicitly create a private right of action. Thus, a civil action to enforce the rights afforded to health care service providers must be brought under §740. As a result, an action to enforce §741 rights does not arise under another law, and it is not waived by institution of a claim arising under §740.

It was over this ruling that Judge Robert S. Smith disagreed with the majority. He argued that under the plain language of §740(7) and consistent with the Legislature's clearly expressed message to plaintiffs not to sue under §740 unless "confident that your claim is excellent," a §741 claim is within the "rights and remedies" waived by a plaintiff who institutes an action under §740.

• ***"Health Care Service" Employees.*** The second question certified by the Second Circuit related to whether the plaintiff even came within the scope of §741. That section extends to employees who perform "health care services." Only those who "actually supply health care services" are covered, not all employees of an employer that provides health care services, and not those (like plaintiff) who merely develop programs or coordinate with employees supplying health care, the Court held.

Endnotes:

1. See, e.g., *Levine v. Wyeth,* 944 A.2d 179 (Vt. 2006), cert. granted, 128 S.Ct. 1118 (2008); *Warner-Lambert v. Kent,* 128 S.Ct. 1168 (2008); *Riegel v. Medtronic,* 128 S.Ct. 999 (2008); *Rowe v. New Hampshire Motor Transport Ass'n,* 128 S.Ct. 989 (2008); *Preston v. Ferrer,* 128 S.Ct. 978 (2008).